



Trade Relations between Pakistan and India



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PREFACE

Trade Relations between Pakistan and India has been authored by **Mr. Pradeep S. Mehta**, Secretary General, CUTS International and his team, as a background paper for Pakistan-India Parliamentarians Dialogue-III facilitated by PILDAT. The paper explores the dynamics, initiatives and future prospects of Trade and Economic relations between the two countries.

Pakistan and India have been trading with each other since 1947 with a brief period of hiatus for nine years: 1965-1974. However, despite a largely uninterrupted trade regime since 1974, the extent of trade between India and Pakistan is limited and almost negligible.

The paper concludes with the optimism that both sides are increasingly realising the need for mutual co-existence and interdependence. Therefore there should be a better political buy-in for not just normalising India-Pak trade relations but to enhance it for the benefit of public of both sides and promote peaceful relations.

As an independent Pakistani think-tank, PILDAT believes that while diplomatic channels for Dialogue must continue, Parliamentarians from both countries should be facilitated on both sides for a greater interaction and developing a better understanding for resolving issues that should lead diplomatic initiatives. It is for this objective that PILDAT has been facilitating Parliamentarians Dialogues.

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Islamabad
January 2012

PROFILE OF THE AUTHOR

**Mr. Pradeep S. Mehta**

Mr. Pradeep S. Mehta is Secretary General, Consumer Unity & Trust Society - CUTS International. A founder Secretary General of CUTS International, Mr. Mehta is a student of economics and law. CUTS was established in 1983 at Jaipur, India which also has offices in Geneva, Hanoi, Lusaka and Nairobi, with the mission of pursuing economic equity and social justice within and across borders. CUTS is engaged in trade, regulatory issues and governance. Mr. Mehta has been an Adviser to the Director General of the WTO and Adviser to the Commerce & Industry Minister of India, among other honours and awards. He has *inter alia* written extensively on Indo-Pak trade relations, which can be seen at: http://www.cuts-citee.org/pdf/Building_Peace_through_Trade_Future_of_Indo_Pak_Relations.pdf.

Abbreviations and Acronyms

CUTS	Consumer Unity & Trust Society
GATT	General Agreement on Tariffs and Trade
MFN	Most Favourite Nation
PILDAT	Pakistan Institute of Legislative Development and Transparency
SAFTA	South Asia Free Trade Agreement
TCI	Trade Complementarity Index
WTO	World Trade Organisation

EXECUTIVE SUMMARY

Bilateral trade between India and Pakistan should be a matter of mutual gain. However, their trade volumes are marred by a plethora of factors: primarily geopolitical and consequent high costs. Besides tariffs, other hurdles arise due to non-tariff barriers, poor infrastructure resulting in costly transportation, poor trade facilitation measures like stringent customs and procedural barriers, and strict visa regime, among others.

A historical review shows that at the time of independence, India and Pakistan were heavily dependent on each other. In fact, India's share in Pakistan's global exports and imports accounted for 23.6 per cent and 50.6 per cent respectively in 1948-1949 which declined to 1.3 per cent and 0.06 per cent respectively in 1975-1976. Pakistan's share in India's global exports and imports was 2.2 per cent and 1.1 per cent respectively in 1951-1952 which gradually went down to 0.7 per cent and 0.13 per cent in 2005-2006. India's trade balance with Pakistan which was US \$ 94.7 million in 2001 has increased to US \$ 948.6 million in 2006 and currently stands at US \$ 1987.4 million as of 2010. Furthermore, the share of Pakistan's import from India in its global imports has increased from 4 per cent in 2008 to 6 per cent in 2010. On the other hand, India's imports from Pakistan remain negligible. This (trade balance in favour of India) often results in political rhetoric, further hindering cross-border trade.

Politically, India and Pakistan are perceived as arch rivals in the region. Since their independence, bilateral economic relations have been affected by political factors. With a vision to enhance peace and prosperity to flourish in the region, the two countries are now progressing toward a closer economic relation realising the synergy of bilateral potential. India granted MFN status to Pakistan in 1996 under the WTO agreement, which was not duly reciprocated by Pakistan. It still maintains a positive list approach to allow some specific commodities to be imported from India. Thus, the Pakistan's Cabinet proposal to grant Most Favoured Nation status to India and the Indian Prime Minister's optimism for gradually moving toward preferential trade agreement have become the underpinning philosophy on which the process of trade normalisation is likely to traverse.

The trade complementarity index (TCI), which measures the degree to which the export pattern of one country matches the import pattern of another, between the two countries reveals that India has moderate level of trade complementarity with Pakistan but the reverse is not true, which opens a great opportunity for India to engage with Pakistan.

Till date, the South Asian Free Trade Agreement (SAFTA) remains an ambitious initiative aimed at boosting regional trade flows but it fell short of its goals. Intra-regional trade continues to stay around 5.00 per cent of total trade of South Asian countries. So far, South Asia as a regional bloc has not made any significant contribution to improve Indo-Pak trade.

The grant of MFN status to India will be mutually beneficial in the sense that it will deepen broad-based engagements, and help reduce the costs and loss of revenues incurred through informal trade – including both illegal as well as third country trade. Pakistan, which is already undergoing a process of industrialisation, shall be able to gain cheaper capital inputs to support this process of economic re-engineering.

As founder members of the General Agreement on Tariffs and Trade and that of the World Trade Organisation, India and Pakistan are obliged to adopt non-discrimination principles of Most-Favoured-Nation and National Treatment which require each GATT/WTO Member to extend similar trade concessions to all other Members. The two countries need to focus on increasing the level of intra-industry trade, which stands at a low level despite geographical contiguity and cultural affinity. Both countries need to put more political weight behind Track 2 diplomacy so as to get better political buy-in for trade liberalisation among a multiple set of stakeholders.

Today there is optimism as both sides are increasingly realising the need for mutual co-existence and interdependence. A bilateral cooperation package covering among others better transport and other forms of connectivity, mutual recognition and harmonisation of standards in pharmaceutical, textile, cement, food products and other major commodities of enhanced trade potential, streamlining of financial transaction facilities, easing visa procedures and operationalisation of an effective arbitration mechanism have to be solicited with right earnest and among a diverse set of stakeholders (including parliamentarians) so that there is a better political buy-in for not just normalising India-Pak trade relations but to enhance it for the benefit of consumers of both sides, and promote peaceful relations.

Introduction

The history of political initiatives between India and Pakistan since the Shimla Agreement of 1972 narrates a story of trust deficit. On numerous occasions it has further worsened, if not totally abandoned due to political détente between both countries. This is not to say that efforts to re-engage have not been made on several occasions, but the same have been marred by political and security issues.

However and more importantly, India and Pakistan are the two countries whose rapprochement has the potential to change the geopolitical dynamics of Asia. At the same time, this possibility often gets stuck on the fundamental question of exploring win-win situations. Enhanced bilateral trade relations are one such avenue to do so. It is, therefore, pertinent to do a historical analysis of bilateral trade engagement between the two nations to decipher a possible road map towards a deeper engagement.

History of Trade between India and Pakistan

Bilateral trade between India and Pakistan should be a matter of mutual gain considering the fact that they were once the same country, and are contiguous. Maritime proximity to each other's major business centres i.e. Mumbai and Karachi offers an additional advantage. However, their trade volumes are marred by a plethora of factors, primarily geopolitical. Besides tariffs, other hurdles arise due to non-tariff barriers, poor infrastructure resulting in costly transportation, poor trade facilitation measures like customs and procedural barriers, and difficult visa regime, among others.

A historical review shows that at the time of independence, India and Pakistan were heavily dependent on each other.

In fact, India's share in Pakistan's global exports and imports accounted for 23.6 per cent and 50.6 per cent respectively in 1948-1949 which declined to 1.3 per cent and 0.06 per cent respectively in 1975-1976.¹ Pakistan's share in India's global exports and imports was 2.2 per cent and 1.1 per cent respectively in 1951-1952 which gradually went down to 0.7 per cent and 0.13 per cent in 2005-2006.²

In 2001, India's exports to Pakistan accounted for US \$ 164.6 million, which increased to US \$ 2,235.8 million in 2010. The imported value of goods from Pakistan was US \$ 69.9 million in 2001, which increased to US \$ 248.4 million in 2010 (Table 1)

This clearly shows that the two countries have not been able to harness their true potential, even though India has been consistently enjoying a positive trade balance with Pakistan. India's trade balance with Pakistan which was US \$ 94.7 million in 2001 has increased to US \$ 948.6 million in 2006 and currently stands at US \$ 1987.4 million as of 2010. Furthermore, the share of Pakistan's import from India in its global imports has increased from 4 per cent in 2008 to 6 per cent in 2010.³ On the other hand, India's imports from Pakistan remain negligible. This (trade balance in favour of India) often results in political rhetoric, further hindering cross-border trade.

Though the statistics reveal a definite growth in favour of India, yet it does not define the true potential that can emanate from strong bilateral relations. Owing to high trade costs, an estimated US \$ 3 billion of informal trade happens between the two countries, which can well be brought into the mainstream economy through better trade facilitation measures.⁴

Table 1: India's Trade Balance with Pakistan (US \$ million)

Year	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Exports	164.6	187.7	183.6	522.1	593.1	1235.0	1584.3	1772.8	1455.8	2235.8
Imports	69.9	33.9	68.1	79.1	165.9	286.5	286.7	372.0	272.1	248.4
Trade	94.7	153.	115.	442.	427.	948.6	1297.	1400.	1183.	1987.
Balance		8.	5	9	1		6	8	7	4

Source: Trade Map, International Trade Centre, Geneva

1. Ghuman, R.S. Indo-Pakistan Trade Relations, New Delhi: Deep & Deep Publications, 1986, p.81; D.G.C.I. & S., Kolkata; and Federal Bureau of Statistics, Islamabad; as quoted in Ghuman, R. S. and D. K. Madaan (2006)
2. *Ibid.*
3. Trade Map, International Trade Centre, Geneva
4. 'A Win-Win Trade for India and Pakistan' by Pradeep S Mehta and Abid Suleri, Financial Express, New Delhi, 18 October 2011, <http://www.financialexpress.com/news/a-winwin-trade-for-india-&-pakistan/861183/0>

Moreover, commodity-wise statistics reveals that the top three Indian exports to Pakistan include sugar and sugar confectionery, cotton and manmade filaments, accounting for US \$ 613.33 million, US \$ 320.04 million and US \$ 300.39 million respectively (Table 2). The top three Indian imports from Pakistan in the same year include edible fruit, nuts, peel of citrus fruit, melons, mineral fuels, oils, distillation products, etc. and organic chemicals, accounting for US \$ 49.31 million, US \$ 37.25 million and US \$ 29.93 million respectively (Table 3).

Regional Geo-Economics and Prospects of Bilateral Trade

Politically, India and Pakistan are perceived as arch rivals in the region. Since their independence, bilateral economic relations have been adversely affected by political factors. With a vision to enhance peace and prosperity to flourish in the region, the two countries are now progressing toward a closer economic relation realising the synergy of bilateral potential. India granted MFN status to Pakistan in 1996 under the WTO agreement, which was not duly reciprocated by Pakistan. It still maintains a positive list approach to allow some specific commodities to be

imported from India.

Considering the low volume of bilateral trade and both countries' urge for a higher degree of regional integration in South Asia, especially through improved physical integration, it is inevitable that they focus on enhancing trade. The process of trade normalisation duly supported by stakeholders is, thus, pushing both nations toward rapprochement.

The visit of Indian Commerce Secretary, Rahul Khullar to Islamabad in April 2011 followed by the visit of his counterpart Zafar Mahmood, and the visit of Makhdoom Amin Fahim, Commerce Minister of Pakistan, to New Delhi has created optimism to strengthen bilateral trade ties. This hope of establishing peace through trade is getting strong support from not only the policy makers but also the business communities of both sides and most crucially, the citizens, at large. Though, contrarian voices are also heard, but that can be expected.

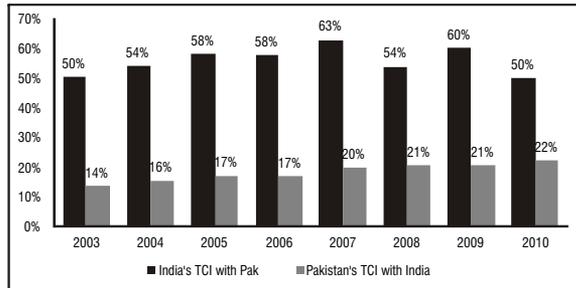
Thus, the Pakistan's Cabinet proposal to grant Most Favoured Nation status to India and the Indian Prime Minister's optimism for gradually moving toward preferential trade agreement have become the

Table 2: India's Top Ten Exports to Pakistan (US \$ million)

Sectors	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Sugars and sugar confectionery	61.91	4.74	6.37	0.53	1.14	372.80	81.68	12.47	1.11	613.33
Cotton	0.66	1.07	5.21	52.61	44.96	107.25	319.66	313.69	135.67	320.04
Manmade filaments	0.01	1.87	0.21	0.00	0.03	0.64	17.78	111.42	414.34	300.39
Organic chemicals	28.54	41.97	56.50	191.57	198.81	270.96	387.70	467.36	295.51	252.13
Residues, wastes of food industry, animal fodder	7.90	2.07	19.32	42.39	47.77	66.75	89.08	102.94	82.64	75.52
Edible vegetables and certain roots and tubers	2.09	1.19	0.78	2.20	28.30	34.64	53.13	68.82	95.47	74.52
Coffee, tea, mate and spices	7.00	7.26	8.88	11.21	13.06	22.94	17.84	63.49	33.04	67.58
Rubber and articles thereof	7.18	14.42	14.95	27.69	40.11	37.99	49.08	49.93	34.14	46.76
Oil seed, oleagious fruits, grain, seed, fruit, etc.	2.39	3.01	2.97	15.15	11.47	15.10	20.33	18.39	30.65	45.42
Miscellaneous chemical products	0.39	0.62	1.73	2.41	5.50	3.06	19.45	34.58	23.22	42.85

Source: Trade Map, International Trade Centre, Geneva

Figure 1: Trade Complementarity Index between India and Pakistan



underpinning philosophy on which the process of trade normalisation is likely to traverse. However, it is for both sides to understand that the granting of *MFN status may not enhance the volume of trade immediately and that it has to be supported by other efforts like reducing non-tariff barriers*.⁵

In a recent statement, Pakistan's Commerce Secretary Zafar Mehmood announced that India has no Pakistan specific tariff and non-tariff barriers. But in order to attain trade normalisation with India, Pakistan has asked for signing of four agreements which includes customs cooperation agreement, mutual recognition agreement,

redressal of grievances agreement and preferential tariff under SAFTA.⁶

The two countries need to assess their trade complementarities and move ahead in a clearly defined direction. The trade complementarity index (TCI), which measures the degree to which the export pattern of one country matches the import pattern of another, between the two countries reveals that India has moderate level of trade complementarity with Pakistan but the reverse is not true, which opens a great opportunity for India to engage with Pakistan (Figure 1). In 2003 India's TCI with Pakistan was 50 per cent while Pakistan's TCI with India was only 14 per cent. India's TCI with Pakistan was highest in 2007 and Pakistan enjoyed the highest TCI in 2010, thus improving its complementarity with India which is a positive sign for Pakistan.

Considering the imperative of enhancing trade relations between them, two lines of thinking broadly emerge out of several studies on Indo-Pak trade relations. One emphasises on the importance of bilateral trade relations even in the presence of political tensions. The examples of progressive trade enhancement between China-Taiwan,

Table 3: India's Top Ten Imports from Pakistan (US \$ million)

Sectors	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Edible fruit, nuts, peel of citrus fruit, melons	27.34	12.40	10.20	22.06	24.80	71.69	59.12	34.93	44.82	49.31
Mineral fuels, oils, distillation products, etc	3.51	6.28	8.69	0.05	1.64	97.03	62.01	154.04	44.15	37.25
Organic chemicals	0.21	0.19	0.02	1.17	7.24	34.83	10.15	7.02	38.95	29.93
Salt, sulphur, earth, stone, plaster, lime and cement	1.22	0.25	0.56	1.05	0.57	0.93	8.96	74.17	37.38	28.39
Cotton	2.35	1.82	3.32	9.26	28.03	43.50	48.06	46.66	34.94	19.12
Lead and articles thereof	0.00	0.00	0.00	0.00	1.51	4.69	25.39	4.09	7.87	12.96
Raw hides and skins (other than furskins) and leather	0.44	0.19	0.49	1.20	1.58	2.61	11.52	13.04	7.93	10.71
Plastics and articles thereof	0.33	0.45	0.60	0.70	1.79	2.07	2.59	3.99	4.90	9.61
Inorganic chemicals, precious metal compound, isotopes	0.25	0.00	0.11	0.10	0.07	0.05	0.07	0.63	6.27	8.97
Wool, animal hair, horsehair yarn and fabric thereof	0.39	0.77	2.14	1.12	1.94	3.38	4.76	4.47	2.47	6.82

Source: Trade Map, International Trade Centre, Geneva

- Pradeep S Mehta in "Pakistan cannot give subsidies from financial aid received from other countries: Indian Financial Expert" (translated version of title as appeared in Urdu daily), Nai Baat, Lahore, December 6, 2011
- "Indian Non-Tariff Barriers: Pakistan demands India to sign four agreements to address NTBs" by Sajid Chaudhry, Daily Times, 23 December 2011, http://www.dailytimes.com.pk/default.asp?page=2011%5C12%5C23%5Cstory_23-12-2011_pg5_9

India-China, US-China and US-Russia are presented on the platform of economic and political discourse between these two nations to explain this point.

The other line of thinking speaks about increasing trade deficit that Pakistan faces with India and argues that more imports from India will further distort the level playing field of Pakistani entrepreneurs.

Thus, a cautious approach is needed to gradually normalise bilateral trade relations. If economic engagement is on a genuine path, it is most likely that the concerned stakeholders, particularly the consumers, will compel the two governments to generate more and more peace dividends from enhanced trade relations.

In this context, it is important to mention an ongoing study by India-based CUTS International and Sustainable Development Policy Institute of Pakistan, and other institutions in Nepal, Bangladesh and Sri Lanka, entitled Cost of Economic Non-Cooperation to Consumers in South Asia supported by The Asia Foundation. It looked at the impact of tariff liberalisation under South Asian Free Trade Agreement (SAFTA) on consumption expenditure of five of the largest countries of South Asia and found that trade between India and Pakistan has the highest growth prospect. The study estimated that annual welfare gains to Indian consumers by importing certain products from Pakistan (as against from rest of the world) would be around US \$ 4 billion and similarly importing certain products from India would benefit Pakistani consumers by US \$ 280 million. Annual estimated gains to a Pakistani consumer would be US \$16.00 and that for an Indian consumer would be US \$3.00 on a per capita basis.⁷

Impact of SAFTA and Best Practices from Other Trade Blocs

Till date, the South Asian Free Trade Agreement remains an ambitious initiative aimed at boosting regional trade flows but it fell short of its goals. Intra-regional trade continues to stay around 5.00 per cent of total trade of South Asian countries.

The primary objective of SAFTA is to generate sufficient

tariff preferences by increasing product coverage under the Agreement's tariff liberalisation programme.⁸ This is because of a general recognition that South Asian Preferential Trade Agreement (the predecessor of SAFTA) failed to achieve its intended objective of enhancing intra-regional trade as a result of limited product coverage and limited extent of tariff concessions exchanged among member countries.

It is to be noted that though, as per their SAFTA commitments, South Asian countries adopted reduced sensitive lists (containing items which are not subject to tariff reduction), the respective lists are still very large and includes many items in which enhanced intra-regional trade can be obtained.

At the time of the commencement of preferential tariff reductions under SAFTA in 2006, all five major countries (Bangladesh, India, Nepal, Pakistan and Sri Lanka) kept 15 to 25 per cent of total product lines under their respective sensitive lists. Since then only marginal reduction has taken place. While India brought down the number of products in its sensitive list for least developed countries from 744 to 484, the list for non-LDCs has remained the same at 860 product lines. Bangladesh, Nepal, Pakistan and Sri Lanka still retains more than 1000 product categories in their sensitive lists, with a hitherto unaccomplished commitment to reduce them gradually.

Reluctance on import liberalisation has affected South Asian trade in general and India-Pakistan bilateral trade in particular. Pakistan had stated at the outset that it will implement SAFTA commitments only in line with its existing bilateral trade policy with India. Pakistan's trade with India thus continue to be governed by a positive list, which allowed only 773 items to be imported from India as on January 1, 2006. SAFTA commitments were applied only on these items. Linking bilateral trade relations with political disputes was the reason why the provisions of the Agreement were under-utilised so far.⁹

Previous estimates show that Pakistan stands to save between US \$ 400 million to US \$ 900 million on its import bill if it allows imports from India on several items replacing its present imports from other countries at higher

7. See 'A win-win trade for India & Pakistan', by Pradeep S. Mehta and Abid Suleri in Financial Express, October 18, 2011

8. SAFTA tariff liberalisation programme stipulates reduction of tariff rates to upper limits of 20 and 30 percent for developing and least developed countries respectively within 2 years from the date of enforcement of the Agreement (that is 01.01.2006). It also requires annual reduction of 10 percent for developing countries and 5 percent for least developed countries during this period for products with tariff rates less than the prescribed upper limits on the date of enforcement

9. Baysan, T., A. Panagariya, and N. Pittigala (2006). "Preferential Trading in South Asia", Policy Research Working Paper No. 3813, World Bank, Washington, DC

costs.¹⁰ Potential import items belonging to this category as identified by this study include tea, spices, auto parts, consumer and light engineering goods, tires and transport equipment, information technology, and pharmaceuticals.

Interestingly, the CUTS (2011) study uses more restrictive scenarios and shows that the potential for increase in trade with full implementation of preferential rates under SAFTA will be the highest in the Indo-Pak bilateral case compared to potential for trade between other SAFTA members.¹¹ The methodology used by this study selects only product categories which already rank high in the import baskets of respective SAFTA members and thus, minimises the risks of displacement of domestic industries – the single most important concern of an importing country. The results shows that for about 70 product categories which are included in their sensitive lists, both countries would save about 60 per cent of their current import expenditure by sourcing from each other at preferential rates rather than resorting to costlier imports from rest of the world. While plastic-based articles will be major import items for India, Pakistan will gain mainly from imports of pharmaceutical ingredients and electrical equipments.

So far, South Asia as a regional bloc has not made any significant contribution to improve Indo-Pak trade. On the other hand, even a cursory look at the landscape of regional blocs around the world would show that relative success of trade agreements involving countries with long-standing geopolitical tension as well as wide gap in economic status largely owes to objective negotiations on non-economic issues. The role of Mercosur in redefining and fostering bilateral relations between Brazil and Argentina as well as that of North American Free Trade Agreement in bringing about benefits to the US and Mexico on various counts are good examples.

Therefore, an immediate priority for India and Pakistan should be to delink trade talks from non-economic issues and consider economic gains from mutual trade in isolation for their own benefits as well as for the greater good for South Asia.

Advantages of MFN Status

As founder members of the General Agreement on Tariffs and Trade and that of the World Trade Organisation, India

and Pakistan are obliged to adopt non-discrimination principles of Most-Favoured-Nation and National Treatment which require each GATT/WTO Member to extend similar trade concessions to all other Members. In the wake of troubled relations immediately after independence, both countries took exceptions to this rule. Though in 1957 India and Pakistan accorded in-principle MFN status to each other through a bilateral pact, it was short-lived. Later, following the transformation of the GATT 1947 to the World Trade Organisation 1995, India granted MFN status to Pakistan as on January 1, 1996 which is yet to be reciprocated, though Pakistan has showed its willingness to extend MFN to India in 2012.

In order to put this issue in the right perspective, certain associated misconceptions should be cleared. As Qamar (2005) reports, the opposition to MFN status for India is quite often based on a wrong perception that giving MFN status is tantamount to giving some special status to India that would result in imports with duties at either zero or less than what is levied at imports from other countries. In reality, MFN status only means that competitive opportunities for Indian and Pakistani manufactures in each other's markets would be equal to that enjoyed by all other trading partners. In the colloquial parlance, MFN translates as "*sabse pasandida mulk*", which sounds anathematical to many in both countries. In the WTO jargon, MFN means that there would be no discrimination practiced by one member against another member of the WTO and the same treatment will be extended as one country does to another country.

Moreover, increase in imports from one to another country following the application of MFN rates can occur through three alternative scenarios:

- i. Indian imports will substitute the items being already imported from other countries as they are placed on the same footing;
- ii. Items which are currently being smuggled or channelled through third countries because of high tariff walls and non-tariff barriers will be brought under legitimate trade as trade costs will come down; and
- iii. Indian imports may displace domestic production wholly or partly from the market as they prove to be cheaper and competitive at MFN rates.

10. Based on 2003-2004 data, Qamar (2005) shows that after excluding the items that are on the positive list for India, 45 per cent of the items could be imported by Pakistan at lesser cost from India than the current cost of import from the rest of the world.

11. CUTS research report titled 'Cost of Economic Non-Cooperation to Consumers in South Asia' is forthcoming in February 2012.

The first two scenarios would not affect domestic production for obvious reasons. The occurrence of the third scenario depends on the relative efficiency of respective manufacturers of both countries and open trade would only help to equalise productive efficiency across border through competitive pressure, benefiting the consumers of the importing country in the long-run.

Revisiting the third scenario, it is unlikely that any import surge following application of MFN rates will threaten the existence of domestic producers in Pakistan in any sector as India's supply capacity matching the entire domestic demand is improbable. Moreover, WTO rules allow members to impose safeguards restricting imports in case of serious injury to domestic manufacturing. Thus, the fear of import surge and subsequent adverse effects are largely misplaced in the context of extension of MFN status to India.

Indo-Pak trade stood at US \$ 2.6 billion in 2010.¹² While some estimates put trade potential at five times this figure, illegal or re-routed trade through third countries is considered to be close to US \$ 10 billion.¹³ Application of MFN rates will help to legalise most of the illegal trade to the best extent possible as well as realise part of unexplored potential. Bulk of this increase in trade will be on products such as chemical-based industrial inputs, machinery and electrical equipment, automobile parts, base metals and metal-based articles, plastics and rubber-based articles, precious or semi-precious jewellery, optical, photographic, and surgical instruments etc., (Kemal, 2004). It would be interesting to analyse the structure of domestic production of these products in Pakistan.

However, the most important spin-off from this development is not the mere prospect of a one-time leap in Indo-Pak trade volumes. While India had applied MFN rates to Pakistani imports, a major obstacle over and above tariff walls became visible by way of non-tariff barriers, especially deficiency of transport infrastructure and procedural opacity.¹⁴ While road and rail transport systems are time-consuming because of delays in border inspection, shipping facilities between the two neighbours are inadequate.

As avoidable trade costs will be partly reduced by the

application of MFN rates, it will help to boost bilateral trade volumes to a minimum level required for attracting mitigation measures toward non-tariff barriers. As trade volume increases, it is expected to result in better trade facilitation measures, procedural ease and economies of scale in the transport sector, better returns and rents from investment in trade infrastructure and additional incentives for private enterprises to explore regional markets.

The grant of MFN status to India will be mutually beneficial in the sense that it will deepen broad-based engagements, and help reduce the costs and loss of revenues incurred through informal trade – including both illegal as well as third country trade. Pakistan, which is already undergoing a process of industrialisation, shall be able to gain cheaper capital inputs to support this process of economic re-engineering.

12. Trade Map 2011, International Trade Centre, Geneva.

13. See Rai and Bhatnagar (2011)

14. Some oft-cited difficulties faced by traders include cumbersome licensing and certification procedures, improper valuation methodology, undue application of standards and inspection delays. For detailed exposition see ADB (2007) and De (2009)

Conclusions and Recommendations

Today there is optimism as both sides are increasingly realising the need for mutual co-existence and interdependence. A bilateral cooperation package covering among others better transport and other forms of connectivity, mutual recognition and harmonisation of standards in pharmaceutical, textile, cement, food products and other major commodities of enhanced trade potential, streamlining of financial transaction facilities, easing visa procedures and operationalisation of an effective arbitration mechanism have to be solicited with right earnest and among a diverse set of stakeholders (including parliamentarians) so that there is a better political buy-in for not just normalising India-Pak trade relations but to enhance it for the benefit of consumers of both sides, and promote peaceful relations.

Effective implementation of the following recommendations will strengthen Indo-Pak bilateral trade:

- i. The two countries need to focus on increasing the level of intra-industry trade, which stands at a low level despite geographical contiguity and cultural affinity. As trade should gradually move from that in goods to trade in tasks, both countries should put their political capital behind an early conclusion of negotiations to include services and investment under the South Asian Free Trade Agreement.
- ii. Since most of the products which have potential for cooperation are currently included in the sensitive list of items to which preferential tariff rates prescribed under SAFTA are not applied, the application of SAFTA preferential tariff rates will help consumers of both sides.
- iii. In order to have a comprehensive and deeper engagement, one of the most crucial issues would be reduction of trade costs. Both countries need to focus on issues, other than tariffs, resulting in high trade costs, which act as impediments to bilateral trade as well as regional integration. An enabling environment for trade enhancement by addressing flanking measures/policies is to be created.
- iv. Owing to high trade costs, an estimated US \$ 3-10 billion of informal trade happens between the two countries, which need to be brought into the mainstream through better trade facilitation measures. The two countries need to tackle the problems of illegal and third country trade through better trade facilitation measures. The Integrated Check Post at Attari/Wagah will help reduce various non-tariff barriers especially those arising out of lack of mechanised loading and unloading facilities, poor infrastructure and stringent customs procedures. It will also help reduce the freight and time costs of trading through Wagah-Attari land route.
- v. Both countries need to put more political weight behind Track 2 diplomacy so as to get better political buy-in for trade liberalisation among a multiple set of stakeholders.

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