Pakistan-India Trade:

What Needs To Be Done? What Does It Matter?

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This publication marks a collaborative effort between the Woodrow Wilson International Center for Scholars' Asia Program and the Fellowship Fund for Pakistan.

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Essays by:

Amin Hashwani
Ishrat Husain
Kalpana Kochhar and Ejaz Ghani
Michael Kugelman
Zafar Mahmood
Ijaz Nabi
Nisha Taneja
Arvind Virmani

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Michael Kugelman
Robert M. Hathaway

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Available from :

Asia Program
Woodrow Wilson International Center for Scholars
One Woodrow Wilson Plaza
1300 Pennsylvania Avenue NW
Washington, DC 20004-3027

www.wilsoncenter.org

ISBN: 978-1-938027-13-0

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The Pakistan-India Trade Relationship: Prospects, Profits, and Pitfalls

MICHAEL KUGELMAN

In November 2011, the government of Pakistan announced its decision to grant Most Favored Nation (MFN) status to India. This means that India, in principle, will enjoy lower tariffs and fewer trade barriers in its economic relationship with Pakistan. The decision, which followed New Delhi's extension of MFN status to Pakistan in 1996, underscores Islamabad's willingness to deepen commercial ties with its long-time nemesis.

The potential for greater trade between the two is considerable. Current trade volume is less than $3 billion, but some experts estimate that a normalized trade regime could eventually send the figure soaring to $40 billion.[1] Such projections take into account, in part, the large volume of informal Pakistan-India trade, which not long ago equaled that of formal trade, and is now estimated at about $1 billion. With more formal trade, according to an estimate from 2011, more Indian cotton, petroleum products, telephones, cars, organic chemicals, and tea will flow into Pakistan, while more Pakistani dates, jewelry, medical supplies, and petroleum oils will surge into India.[2] Many of these exports are now transacted informally (such as by smuggling or through third countries).

TRADE TALK

In 2012, intensified trade diplomacy between Islamabad and New Delhi yielded a range of achievements. Early in the year, Pakistan abolished

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Michael Kugelman is the senior program associate for South Asia at the Woodrow Wilson International Center for Scholars.

its positive list of 2,000 goods that could be imported from India, and replaced it with a negative list of about 1,200 items that could not be imported (more than 500 of these untradeable items belonged to the automobile, iron, and steel sectors). Islamabad pledged to eliminate this negative list entirely by the end of 2012, thereby bringing the two countries closer to a fully operational MFN regime.

In April, the two capitals launched a new integrated checkpoint at the Attari-Wagah land border crossing, generating promises from both countries that trade through this sector would increase tenfold. On the same day, India announced that it would permit foreign direct investment (FDI) from Pakistan. Over the summer, New Delhi removed a ban on Pakistani businesses setting up operations inside India. In September, the two sides concluded a landmark visa agreement that loosens travel restrictions. Later in the year, Islamabad announced new measures to boost capacity on its side of the Attari-Wagah border, including the installation of additional scanners and weighbridges, and the deployment of more customs officials to the site.

Many observers believe increased trade will benefit each country's economy, but also build constituencies for more cooperative bilateral relations—in effect opening the door to progress on core political and security issues.

This is certainly an argument endorsed by Islamabad. Several months after Pakistan's MFN announcement, Pakistani Foreign Minister Hina Rabbani Khar stated in a speech at the Lahore University of Management Sciences (LUMS) that more trade with India would enhance Pakistan's prospects for peace and prosperity, and "put in place the conditions that will enable Pakistan to better pursue its principled positions" on territorial issues.[3]

In 2012, recognizing the significance of trade in the Pakistan-India relationship, the Asia Program of the Washington, DC-based Woodrow Wilson Center, with co-sponsorship from the Wilson Center's Program on America and the Global Economy, and with generous support from the Karachi-based Fellowship Fund for Pakistan, hosted a conference on Pakistan-India trade. The contributions in this volume were originally presented at this conference.

THE ROAD TO MFN

In the first essay, **Zafar Mahmood**, Pakistan's commerce secretary at the time of the conference (he was appointed water and power secretary several weeks later), offers an insider's account of the events leading to Islamabad's decision to grant MFN status to New Delhi. When the two sides restarted their Composite Dialogue process in 2011 (it was launched in 2004, but suspended after the 2008 Mumbai terror attacks), a breakthrough on trade may have seemed unlikely. Pakistan was still unhappy about the revelation—brought to light in a 2007 analysis produced by an Indian think tank—that Indian traders importing goods from Pakistan were under surveillance by Indian intelligence agents. Additionally, to Pakistan's chagrin, India—despite Mahmood's personal appeal to New Delhi's World Trade Organization (WTO) ambassador—was opposing a European Union (EU) assistance package offered to Pakistan in the aftermath of the latter's devastating 2010 floods.

Mahmood credits the savvy diplomacy of Anand Sharma, India's commerce minister, for helping engineer a turnaround. Sharma invited his Pakistani counterpart to New Delhi in September 2011. The meeting resulted in India dropping its opposition to the EU package, and both ministers agreed to pursue full trade normalization. This visit, Mahmood writes, "created a conducive environment for Pakistan to move forward," and in early November Pakistan's Cabinet reached its MFN decision.

PAKISTAN-INDIA TRADE: A CHECKERED PAST

According to Mahmood, cordial bilateral trade ties are nothing new. In fact, he writes, they have often blossomed even while political relations wilted. In 1948–49, 56 percent of Pakistan's exports were sent to India. For the next several years—a period of tense political relations—India was Pakistan's largest trading partner. Between 1947 and 1965, the two nations entered into 14 bilateral agreements related to trade facilitation. In 1965, the year Pakistan and India went to war over Kashmir, nine branches of six Indian banks were operating in Pakistan. And in 1972, following another Subcontinental war the previous year, the two sides concluded an agreement that produced a resumption of limited trade.

At the same time, trade ties have often become a casualty of the decades-old mistrust and enmity hampering Pakistan-India political relations. **Ijaz Nabi**, a visiting professor of economics at LUMS, traces the first major trade dispute to 1949. That year, India devalued its currency, but Pakistan refused to follow suit. In retaliation, New Delhi imposed an import duty on jute, one of Pakistan's chief raw materials exports to India. Pakistani restrictions on imports of Indian manufactured goods soon followed. These developments contributed to Pakistan's decision to launch a relatively successful import-substitution strategy in the early 1950s (Pakistan's average annual GDP growth would exceed 6 percent for several decades). The 1965 and 1971 wars "severely disrupted" cross-border trade, Nabi writes, and it "never really recovered."

THE CASE FOR TRADE NORMALIZATION

Nabi, echoing the views of this collection's other contributors, asserts that greater Pakistan-India trade can bring tremendous benefits to Pakistan. Consumers would enjoy lower product prices and more variety. Technology transfers from India would improve Pakistani farm productivity, while lowering manufacturers' production costs and enhancing their competitiveness internationally. Small manufacturers would increase their efficiency by partnering with larger Indian counterparts, and enjoy advantages of scale thanks to bigger export markets. Finally, the Pakistani government would benefit because more legalized trade would generate revenues currently lost to smuggling. In fact, Nabi writes, Islamabad should tap into this increased revenue to provide "compensation measures" to those who suffer from trade normalization.

India can also gain immensely from increased trade, according to International Monetary Fund official **Arvind Virmani**. He identifies two reasons why the Indian business community is particularly supportive. One is that Indian business leaders already know liberalization works, because domestic economic reforms in the early 1990s—which slashed tariffs and ended decades of protectionism—made the country's industries stronger. "We expected industry to adapt, adjust, and survive—and it did," writes Virmani, who has served as a chief economic adviser to the Indian government. Another reason why Indian businesses favor more trade is the strong "historical memory" prevailing in the western Indian states bordering Pakistan. Here, people fondly remember the trade corridors and other economic linkages with present-day Punjab province in Pakistan—links that flourished pre-Partition and persevered until the Pakistan-India war of 1965.

Virmani calls on Indians and Pakistanis to better publicize the positive dimensions of bilateral trade. These include the fact that more trade would eliminate the "deadweight loss" resulting from diverting commerce to third countries. Additionally, using examples from the free trade agreement between India and Sri Lanka, he discusses how nations can enjoy new advantages of economies of scale. Sri Lankan tea exporters were long shut out of India, one of the world's largest producers. Now, however, they can easily "test" their products in southern India; many have now established operations and brands in Tamil Nadu state.

THE RISKS OF TRADE NORMALIZATION

There is, however, another side to this story. Economists often say that free trade creates both winners and losers. Indeed, numerous sectors and interests in Pakistan have expressed strong misgivings about increased trade with India.

Particularly outspoken in its opposition is the Pakistani automobile industry, which had more items on the negative list (385, according to data provided in this volume) than any other sector. In late 2012, the chairman of the Pakistan Association of Automotive Parts and Accessories Manufacturers warned that local car parts makers "will be hurt significantly" by trade liberalization because the "nascent industry" cannot compete with India's formidable auto sector. He called on Islamabad to wait at least 10 years before lowering tariff lines in this sector.[4]

Some agricultural interests are unhappy as well. A 2012 *Foreign Policy* report found Pakistani farmers worried about the prospect of heavily subsidized (and hence cheaper) food imports coursing into Pakistan from India. (However, in the same report, other food producers relished the prospect of acquiring better-quality foodstuffs from India, because of their expected profitability in Pakistani food markets.) A major concern of farmers is that agricultural trade will not serve Pakistan's comparative advantage;

some food wholesalers fear that India will flood Pakistani markets with bananas and oranges, which already exist in abundance in Pakistan.[5]

Similar concerns were voiced in focus group consultations with business leaders overseen by Karachi's Institute of Business Administration (IBA) in early 2012. **Ishrat Husain**, IBA's dean and director, highlights the findings from these conversations in his essay. He writes of agricultural producers' fears that they will be unable to compete with their Indian counterparts, who in some states benefit from "hidden and implicit" subsidies (including for electricity to power tubewells). Meanwhile, car parts manufacturers are anxious that Indian parts "will flood the Pakistani market and decimate the local industry," and that Pakistani exports will suffer because Indian car makers prefer domestically manufactured parts. Husain also reports unease within the pharmaceutical and chemical/synthetic fiber industries. The first sector believes that India's abundance of raw materials and large economies of scale will "squeeze out" Pakistani products, while the second predicts that India, with such a large surplus of fiber, will simply dump its excess in Pakistani markets.

Husain also discusses factors beyond sectoral opposition that risk derailing the Pakistan-India trade regime. First, opposition political parties in both countries, possibly aligned with "extremist elements," could take virulently anti-trade positions that pressure Islamabad and New Delhi into supporting less trade-friendly policies. Second, the "losers lobby"—powerful industries in both nations that feel threatened by greater trade—could prevail on their governments to impose retaliatory trade measures. Finally, the powerful Pakistani and Indian media could take up the cause of smaller industries that suffer from trade liberalization, and "create such venom that trade flows could be set back." Given these risks, Husain concludes, it is essential that both sides are proactive in their management of trade policies and processes, and vigilant in their implementation.

NAVIGATING NON-TARIFF BARRIERS

Free trade, not to mention a full-fledged MFN relationship, requires not only the simple exchange of low-tariff goods, but also the smooth and unfettered flow of goods within countries and across borders—a rarity in South Asia. Indeed, several contributors to this volume express concern about non-tariff barriers to trade on the Subcontinent. These include oppressive licensing and customs requirements, draconian visa policies, long waiting periods at borders, and poor road conditions.

Nisha Taneja, a professor at New Delhi's Indian Council for Research on International Economic Relations, addresses these challenges in her essay, with particular emphasis on transport and transit obstacles. Presently, Pakistan-India trade is permitted on only one land route (via the Attari-Wagah border crossing). Road border infrastructure—warehousing, parking facilities, testing laboratories—is poor, and extensive security checks cause major congestion. Meanwhile, rail routes for trade can carry goods across an expanse of only 30 kilometers. Train cars are in scarce supply, and only certain types are permitted for trade. These problems on direct trade routes have been so widespread, according to Taneja's research, that a few years ago several circuitous indirect routes were found to be twice as trade-efficient (as measured by transaction costs incurred per container per kilometer).

Many Pakistanis argue that non-tariff barriers in India are particularly damaging; in Husain's focus group discussions, Pakistani businesspeople identified 17 such obstacles. According to Husain, they fear that, barring Indian corrective actions, such obstacles will undermine "the smooth flow and desired level of exports" from Pakistan. Taneja, however, believes that some of this criticism is misguided. She contends that some measures described by Pakistan as discriminatory are in fact permitted by the WTO on safety and health grounds. Other measures cited by Islamabad, according to Taneja, represent what were once legitimate grievances, yet, perhaps unbeknownst to Pakistan, have since been addressed by New Delhi.

Nonetheless, Taneja concedes that non-tariff barriers are a major concern, and must be addressed if deeper bilateral trade is to materialize. She is echoed by **Kalpana Kochhar** and **Ejaz Ghani**, both of the World Bank. Their essay argues that for India and Pakistan to enjoy the "greatest gains" from MFN and liberalized trade, "accompanying reforms of trade facilitation and connectivity"—especially infrastructural and institutional improvements—are essential. The authors undertake an exercise that simulates two different scenarios. In the first one, Pakistan simply extends MFN to India. In the second, Pakistan extends MFN to India, but at the same time an element of trade facilitation is introduced—transportation costs for bilateral trade decrease by 25 percent. The gains are much higher in this latter scenario; Pakistan's exports to India rise by more than 200 percent, compared to less than 1 percent in the first scenario.

REGIONAL RAMIFICATIONS

Kochhar and Ghani insist that more trade facilitation will result in gains not only for India and Pakistan, but for South Asia on the whole. The region is one of the world's least integrated, and is plagued by poor electricity grids, railways, and roads; damaging trade costs, as illustrated by the long waiting periods for trucks at border crossings (lines at the India-Bangladesh border can last 99 hours); and crushing poverty. However, their essay argues, better trade facilitation would generate such an increased flow of commerce that regional growth could increase by 1 to 2 percent. At the same time, Pakistan-India trade need not be accompanied by trade facilitation measures in order for broader South Asia to benefit; the authors note that a mere increase in the exchange of goods can increase the prospects for a variety of region-wide boons—from increased FDI flows to transboundary gas pipelines.

According to Nabi's essay, South Asia's economic revitalization would serve Pakistan particularly well, given its geographic position. 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 the imposition of colonial-era borders and poor relations with India. A liberalized regional trade regime, he writes, "will help restore the vibrancy" of the Pakistani economic and cultural centers—including Sindh province in the south and the cities of Lahore and Peshawar further north—that served these former east-west trade routes.

PRECARIOUS POLITICS

In her speech at LUMS, Foreign Minister Khar declared that normalizing trade with New Delhi "helps make better a relationship that has for too long been based on mistrust and the baggage of history." Unfortunately, however, despite the resumption of ministerial-level talks in early 2011 and a series of subsequent confidence-building measures, Pakistan-Indian political relations remain deeply troubled.[6] Hostility is still entrenched in public sentiment; a Pew poll released in September 2012 finds majorities on each side viewing the other unfavorably, with Indians describing the Pakistani state as more of a threat than the virulently anti-India Lashkar-e-Taiba militant group.[7] Many in Islamabad continue to regard India as an existential security threat that has never reconciled itself to Pakistan's existence. New Delhi, meanwhile, remains angry about Pakistan's refusal to pursue legal proceedings against the perpetrators of the 2008 Mumbai terror attacks, and is also anxious about Pakistan's nuclear arsenal. Most critically, there has been no progress on resolving the territorial tensions that have triggered three wars between the two countries.

Some observers, in fact, contend that Islamabad's decision to liberalize trade with India could eventually produce great disillusionment in Pakistan, because India has no intention of making the territorial concessions, especially regarding Kashmir, that Islamabad hopes closer trade ties will eventually bring about. According to these observers, New Delhi sees stronger commercial relations as an end in themselves—and wishes that Islamabad would view trade ties in the same way. One analyst warns that by maintaining a rigid status-quo position on territorial issues, India "deprives itself of diplomatic flexibility, while also undermining the constituency for peace inside Pakistan."[8]

Amin Hashwani offers a more optimistic perspective in this volume's final contribution. Hashwani, a Pakistani businessman and founder of the Pakistan-India CEOs Business Forum, insists that more trade truly can improve the bilateral relationship. In fact, he argues that a deep reservoir of goodwill is already well in place. "The positive chemistry that exists on a people-to-people level is unmatched and unprecedented," he writes, underscoring the "warmth displayed for the other" on college campuses and in boardrooms in both countries. Additionally, he acknowledges that while Indian perceptions of Pakistan tend to be "dimunitional and frequently quite negative" due to distorted media portrayals, he points out that Pakistani writers and musicians have been making major inroads with Indian audiences in recent years.

Trade normalization, Hashwani argues, will tighten these links "and create many other unforeseen and unintended interdependencies." He commends each country's politicians for initiating normalization, but underscores the potential for greater benefits to accrue if they "demonstrate the proper leadership to push this process further."

RECOMMENDATIONS

Indeed, a recurrent theme in this volume is that while each country has taken promising first steps to intensify bilateral trade, there is still much to be done. These essays provide a range of suggestions about how to consummate Pakistan-India trade normalization; some of the major ones are described below. They appear here not for the sake of endorsement, but rather to spark additional debate about proper next steps.

For Pakistan

1. **Craft a more comprehensive trade policy**. Current policies lack strategic focus, and are mainly concerned with protecting local monopoly interests. Pakistan should devise measures that promote open commerce, not protectionism. This will entail a stronger emphasis on improving transit trade, transport infrastructure, and cross-border banking. Pakistan's trade policy should regard India's economic growth as an opportunity, not a threat. It should draw on India's skilled worker pool and cutting-edge technologies in order to enhance its own competitiveness.

2. **Expand the national security paradigm to include economic stability and trade**. Economic hardship is a driver of Pakistan's widespread violence, yet trade can fuel growth in economically depressed areas. Additionally, economic liberalization can help ease security fears; experts estimate that trade volumes in the $10 to $15 billion range can make trade gains powerful enough to outweigh geostrategic concerns.

3. **Protect liberalization's losers**. Islamabad should use its increased revenues from tariff collection, customs duties, and other outcomes of expanded legal trade to compensate those who do not benefit from

trade normalization. Outside stakeholders should help soften the negative impacts of trade liberalization by promoting comparative advantage and fostering interdependencies in vulnerable sectors. For example, Japan should ensure that some of its automobile companies operating in Pakistan export to India, while some of its India-based firms export to Pakistan—even while it arranges for some of its Pakistan-based companies to import from sister companies elsewhere in Pakistan.

For India

1. **Promote a selective export policy toward Pakistan**. India enjoys a sizeable trade surplus with Pakistan. At least in the short term, India should increase exports to Pakistan (such as machinery and technology) that the latter currently imports from other countries at high prices, but hold back on exports that could hurt Pakistan's small and medium businesses.

2. **Devise trade measures that are sympathetic to the region's economic asymmetries**. India's economy—blessed with a large industrial base and skilled labor pool, and accounting for more than 80 percent of gross regional product in South Asia—is the most powerful in the region. New Delhi should grant more trade concessions to its smaller neighbors—including by unilaterally removing tariff and non-tariff barriers. It should also address the restrictions it imposes on remittances to Pakistan, which are problematic for India-based Pakistani service providers. Addressing these long-held grievances can increase both Pakistani and regional goodwill toward India.

3. **Simplify, and make more transparent, all trade rules and procedures**. To prevent confusion in, and miscommunication with, Pakistan about non-tariff barriers (whether real or perceived), India should make its trade regulations clearer—especially for food produce, pharmaceuticals, and other products requiring prompt processing. India should also boost the capacities of its laboratory and certification facilities used for trade purposes, and keep the WTO informed about its trade-related decisions pertaining to Pakistan.

For Pakistan and India

1. **Empower the private sector**. Business communities must be on the front lines of trade liberalization. In South Asia, economic relations are better served by the action-oriented, proactive, problem-solving approach favored by the private sector than by the more plodding, reactive, and bureaucratic style associated with governments. Additionally, the private sector is a powerful shaper of public opinion on trade (popular support for trade normalization increased in Pakistan after its business community became convinced of India's willingness to move forward). Public-private partnerships, particularly those that facilitate more interconnectivity through infrastructural improvements (such as by upgrading highways), should also be embraced.

2. **Engage the media**. In both Pakistan and India, media outlets, like the business sector, exert a powerful influence on public sentiment. The media can therefore be a useful tool to amplify the advantages of bilateral trade. Media reportage should spotlight consumers pleased about the cheap goods they import from across the border, and producers happy about the lower costs associated with importing raw materials and machinery. Notably, the Aman-ki-Asha initiative, a joint project of the largest media houses in Pakistan and India, has already spearheaded bilateral cooperation in business, the arts, and society.

3. **Loosen restrictions on transit**. India and Pakistan restrict each other's ability to use the other's territory to reach third countries. India has not allowed Pakistan to access Nepal, Bangladesh, and Bhutan via its territory, and Pakistan has not given transit rights to India to access export markets in Afghanistan. Such transit limitations (along with related concerns about rigid visa regulations) must be placed on the normalization agenda. This is essential if the full benefits of region-wide trade (stretching from China to Iran) are to be enjoyed.

4. **Enhance the efficiency of trade routes**. Swift and cost-efficient interstate (and intrastate) movement of goods will entail removing restrictions on the type and size of trucks and train cars; ameliorating the quality of the roads and railways used for trade in both

countries; and improving infrastructure at border crossings. Despite recent upgrades at the Attari/Wagah border, the need for x-ray machines, better warehousing, and testing laboratories remains strong. So long as direct routes are marred by such inefficiencies, traders will have little incentive to abandon the longer, more circuitous routes they have patronized for decades.

5. **Establish new oversight institutions**. A bilateral commission should be set up to oversee the Pakistan-India economic relationship, with a focus on addressing non-tariff barriers; opening up more land routes for trade; and promoting more cross-border travel. A regional trade forum (comprising members of the private sector, academia, and the media) should be formed to monitor this bilateral commission. To accommodate inevitable disagreements, a dispute resolution/grievance redressal mechanism should be established as well. It should be operated not by the two governments, but by a private sector consortium incorporating the Confederation of Indian Industries, Federation of Indian Chambers of Commerce and Industry, Pakistan Business Council, and Federation of Pakistan Chambers of Commerce and Industry.

6. **Use bilateral trade normalization as a springboard for South Asia-wide trade normalization**. Tighter Pakistan-India trade links—lubricated by more integrated and efficient transport networks and more open transit and visa arrangements—can raise the entire region's trade prospects. Pakistan's extension of MFN status to India puts Pakistan and India on a more equal footing within the South Asia Association of Regional Cooperation, and provides impetus to activate the long-moribund South Asian Free Trade Agreement (SAFTA).

7. **Remain committed to the Composite Dialogue process**. If this negotiating process is sidelined, critics of trade normalization in Pakistan would be emboldened, because they could argue that Pakistan's principled positions on political and territorial issues have been sacrificed for purely material gain. Such critics could also assert that more trade does nothing to resolve these core issues.

8. **Ensure that security and political tensions are not allowed to derail trade diplomacy**. To protect the integrity of both trade normalization and the broader peace process, India should not impose punitive trade measures on Pakistan, or close its borders, in the event of isolated terrorist attacks perpetrated by Pakistan-based extremists (who might like nothing better than to spark a harsh Indian response). Both sides should take care not to allow new security or political tensions to spill into trade or economic relations. Suspending trade in retaliation for developments on the security front will further undercut trust, and complicate efforts to establish a stable and long-term bilateral economic and political relationship.

9. **Act now, before the opportunity is lost**. Economic circumstances dictate that each side act expeditiously to cement trade normalization. Comparative advantage exists not only in terms of goods to be traded, but also business climate (Pakistan is currently ranked higher than India on numerous doing-business and infrastructural-efficiency measures). This could change, however, if India lowers its business costs and upgrades its infrastructure. Additionally, rich-country trading partners are facing economic slowdowns, and Europe's financial crisis has contributed to diminished exports and portfolio capital, as well as to reduced GDP growth in developing countries. This all provides an added incentive to ramp up Pakistan-India trade.

THE PERILOUS PATH FORWARD

Some of these recommendations—establishing a more permissive visa regime, easing transit and transport bottlenecks, instituting grievance redressal mechanisms—are already being addressed. Others—rejuvenating SAFTA, unilaterally removing tariffs—will require more time.

Additionally, old habits die hard. Over the course of 2012, Pakistani and Indian media reports periodically highlighted setbacks to trade normalization that were linked to political or security concerns. At one point, a senior Indian official stated that momentum had slowed because Islamabad was linking trade "to progress on bigger issues such as

Siachen and Sir Creek talks. It is unfortunate but true."[9] A few weeks later, Pakistan's government announced that it could not conclude an oil trade deal with India. The reason given was Pakistan's insistence that it not import more than 25 percent of its petroleum needs from India, because of "security considerations."[10]

Moreover, despite the wealth of trade accomplishments in 2012, the year drew to a troubling close. After Pakistan removed agricultural goods from its negative list in November, farmers—a large component of Pakistan's labor force (about 40 percent of Pakistani jobs are agricultural)—ominously threatened "to take matters into their own hands," including "physically blocking" agricultural imports from India. Meanwhile, India's economy continued to stumble toward year's end, raising the prospect of increased populist and protectionist sentiment in that nation.

Nonetheless, potential remains high. The two governments and business groups continue to meet regularly, and officials frequently offer reassurance—not to mention bold predictions. In November 2012, the president of the Lahore Chamber of Commerce and Industry, speaking at a meeting with visiting dignitaries from nearby Indian Punjab, projected that bilateral trade would rise up to $5 billion in just a couple of years—nearly double the current volume.[11]

Ultimately, the trade normalization process will experience highs and lows. Yet this volume's contributors are emphatic that the reasons for pushing forward on trade are compelling, with immense potential payoffs for both sides—and beyond the region as well. As Mahmood, the former Pakistani commerce secretary, writes in his essay: "Although the [trade] process between the two countries is bilateral, the entire world has a stake in peace in South Asia."

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This book and the conference that preceded it represent the ninth in an ongoing Wilson Center series on critical economic challenges in Pakistan. This project is very generously supported by the Fellowship Fund for Pakistan (FFFP) in Karachi. We are deeply indebted to Munawar Noorani, FFFP's chairman, and to the other members of the FFFP board of trustees and advisory council for their encouragement,

counsel, and support. We also are very appreciative that Mr. Noorani was able to travel to Washington to participate in the 2012 conference.

The editors also wish to single out several Wilson Center colleagues. Joshua Spooner of the Asia Program provided invaluable administrative and operational assistance for the conference and the book. Kent Hughes and Elizabeth Byers of the Program on America and the Global Economy were helpful and enthusiastic co-sponsors. And we thank Senior Scholar William Milam for making an invaluable contribution to the conference.

We owe another large debt of gratitude to this volume's eight contributors. They are all busy people, and we are very thankful to them for sacrificing their own precious time to participate in the conference and to produce thoughtful essays.

Finally, this volume is dedicated to our children and grandchildren: Adam, Connor, Dylan, Hana, Holly, Wren, and Zoe. If trade liberalization does indeed represent a first step toward eventual and lasting peace on the Subcontinent, then this youngest of generations will celebrate the leadership in Pakistan and India whose foresight and political courage led to such a happy outcome.

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Moving Toward Pakistan-India Trade Normalization: An Overview

ZAFAR MAHMOOD

The impediments to Pakistan–India trade have been the focus of intense attention for a long time. Although a number of experts and institutions like the World Bank have supported the liberalization of trade between the two countries, fears and apprehensions as well as the adversarial bilateral relationship between the countries have not allowed them to move forward in this particular domain. As is the case in most parts of the world, trade and politics intermingle on the Subcontinent.

In the last year, however, trade ties have been improving significantly. Why there is a thaw in bilateral trade relations now and not before may be a valid question playing on the minds of people following the trajectory of trade relations between the two countries.

HISTORICAL CONTEXT

In order to fully understand what has happened over the last year, it may be useful to look at the historical perspective, right from the time that the two countries became independent. As we know, in August 1947, the British colonial government partitioned the Dominion of India into the independent countries of Pakistan and India.

The General Agreement on Tariffs and Trade (GATT) was negotiated almost at the same time that Partition was leading to the creation of Pakistan. The founding members of GATT, keeping in view the fact that the Subcontinent was more or less a single economy, allowed special dispensation for the two countries under Article 24 (paragraph 11) of

Zafar Mahmood is a former commerce secretary of Pakistan.

GATT. The accord was signed by 23 countries, including Pakistan and India, on October 23, 1947. India ratified GATT on July 8, 1948, and Pakistan followed suit on July 30, 1948.

The founding fathers of both countries did not envisage adversarial relations between the two countries. To the contrary, Mr. M.A. Jinnah, the founding father of Pakistan, had a very positive vision for Pakistan-India relations. He believed that the two states would co-exist in peace and harmony like the United States and Canada. Unfortunately, even before they attained independence, problems started to bedevil relations.

It started with cross-border migration from both sides. Large numbers of Hindus living in what is now Pakistan and Muslims in what is now India were forced to cross borders amidst a frenzy of communal violence. Tragically, over a million of the 14.5 million who decided to move in either direction lost their lives.

In addition to bloodshed and mayhem on an unprecedented scale for the region, there was the controversial annexation of princely states. In particular, the dispute over Jammu and Kashmir created deep suspicions, and over the years was the single most important issue that significantly contributed to the outbreak of hostilities between the two sides.

It must be noted that while all this was going on, the political leadership kept trade and economic issues separate from politics. In 1948–49, Pakistan's exports to India accounted for 56 percent of its total exports, while 32 percent of Pakistan's imports came from India. The two countries were trading normally during this turbulent period. India was Pakistan's largest trading partner, and this continued to be the case until 1955–56.

Between 1948 and 1965, Pakistan and India used a number of land routes for bilateral trade. These included eight customs stations in Punjab province at Wagah, Takia Ghawindi, Khem Karan, Ganda Singhwala, Mughalpura Railway Station, Lahore Railway Station, Haripur Bund on River Chenab, and the Macleod Ganj Road Railway Station. There were three custom checkposts in Sindh at Khokrapar, Gadro, and Chhor. Pakistan and India, invoking Article 24/paragraph 3(a) of GATT, even signed a bilateral agreement on December 22, 1957, to facilitate border trade.

Similarly, Pakistan and Afghanistan signed a number of agreements to facilitate land trade. The two countries signed the First Pakistan-

Afghanistan Transit Trade Agreement on May 29, 1958, in Kabul, which allowed the transit of goods from India via Lahore. Pakistan also signed a transit trade agreement with Nepal in January 1962, which allowed the transit of goods via the territory of what was then East Pakistan, and is now Bangladesh.

From 1947 to 1965, Pakistan and India entered into 14 bilateral agreements related to trade facilitation. These agreements covered avoidance of double taxation, trade in goods, food items, trade facilitation, border trade, air services, and banking.

The spirit of pragmatism at this time led to an arrangement under which Pakistan exported grain from Sindh to deficit provinces of India, and India exported flour to East Pakistan. Both Pakistan and India had bank branches in each other's country. In 1965, there were nine branches of six Indian banks operating in Pakistan. Pakistan's Habib Bank had a branch in Mumbai.

But all this changed abruptly. The unresolved Kashmir dispute came into play. In 1965, war broke out between the two countries. This time, trade and economic relations became causalities of war. On the fateful morning of September 6, customs officers at Wagah post near Lahore became the first civilian prisoners of war, and banks in both countries were seized as enemy properties.

After the 1971 war, which resulted in the dismemberment of Pakistan, the Simla Agreement was signed between Pakistan and India in 1972. Under this agreement, trade resumed on a limited scale in 1974. Both countries worked on positive lists, which expanded incrementally over the years. This continued until 1995, when, upon signing the World Trade Organization agreement, India unilaterally discontinued its positive list for trade in goods with Pakistan.

Pakistan, however, was prepared neither to react nor to reciprocate in similar fashion. Lobbies linked the settlement of the Kashmir dispute to complete normalization of trade with India. Immediately thereafter, the Pakistani private sector tried to export items to India which were previously prohibited. India was obviously not pleased because of the lack of reciprocity on the part of Pakistan. Pakistani exporters who tried to export without properly studying India's import regime burned their fingers. They encountered India's non-tariff barriers (NTBs). The result was obviously not good. It created a strong negative perception in the minds of our exporters who, to this day, generally believe that India does not welcome exports from Pakistan.

In 1998, nuclear tests were conducted by India, and Pakistan followed suit. Political relations between the two countries became tense. The war in Kargil the following year further soured already frayed political ties. Fortunately, however, the serious friction in political relations did not disrupt trade relations in any significant manner.

In 2002, Pakistan's private sector got another jolt. When Pakistan's exporters were given a concessionary package by the EU, India promptly filed a case with the WTO. It is important to emphasize here that Pakistan's exporters suffered when Pakistan became a partner in the war on terror, and in fact they became a victim of that war. Immediately after the sad day of 9/11, Pakistan became a war zone, and the cost of Pakistan's exports went up because of increases in insurance premiums. Buyers were demanding air-liftings of samples and inventories to third countries. Exporters started facing problems in obtaining visas. It was while Pakistani exporters were facing these challenges that India filed the case against the EU package. This hostile act further strengthened the Pakistani private sector's perception of India as the "enemy."

RECENT DEVELOPMENTS

In January 2004, the governments of India and Pakistan announced the start of a Composite Dialogue process. Trade relations were one of the areas of focus. Four rounds were held between 2004 and 2007:

a. First Round (August 8, 2004, Islamabad)
b. Second Round (August 9–10, 2005, New Delhi)
c. Third Round (March 28–29, 2006, Islamabad)
d. Fourth Round (July 31–August 1, 2007, New Delhi)

The rounds were not very productive. There was only incremental progress. When in January 2011, I was told by our foreign minister that trade had been included as a track in the Composite Dialogue, I studied the minutes of these four rounds. To my surprise, the minutes of the Composite Dialogue made no mention of complete normalization of trade relations or the granting of MFN in the trade of goods. The Indian side had only asked for the inclusion of additional items during the last round of talks held in 2007.

After the unfortunate terrorist attacks in Mumbai on November 26, 2008, the Composite Dialogue process was suspended.

At the time of resumption of the Composite Dialogue process in 2011, the respective position of the two countries was as follows: India saw the positive list arrangement for imports from India by Pakistan and non-implementation of South Asian Free Trade Area (SAFTA) obligations as barriers to trade. The private sector in Pakistan thought that India was not allowing a level playing field, despite the abolition of the positive list, due to the following NTBs:

a. Visa and travel restrictions
b. Technical standards and regulations
c. Limited number of ports and inland custom posts for imports
d. Cumbersome and complex import regulations
e. Customs clearance and customs valuation

Also, a report from India was widely quoted in Pakistan to show the insincerity of India. In October 2007, the Indian Council for Research on International Economic Relations (ICRIER) commissioned a two-part report titled "India Pakistan Trade Possibilities and Non-tariff Barriers."[1] The first part, dealing with trade opportunities between India and Pakistan, was funded by the Ratan Tata Trust, and the section on non-tariff barriers was funded by India's Ministry of Commerce. The study was conducted by Dr. Nisha Taneja.

The findings of the report on NTBs brought out an astonishing fact—Indian importers who had experience importing from Pakistan were reluctant to be interviewed, but told the compiler of the report that they were subjected to surveillance by Indian intelligence agencies. Similarly, they complained that the goods they imported were subjected to multiple checks for security screening. After going through the report, I got the impression that the Ministry of Commerce in India was not aware of the conduct of the security agencies, as otherwise it would not have commissioned such a study. However, this report was in the public domain and came to the attention of Pakistan's intelligentsia as well as its exporters.

This further reinforced the impression in the minds of Pakistan's exporters that India would not allow unhindered access to its market.

When I mentioned the contents of the report to India's delegation after the resumption of the Composite Dialogue in 2011, they responded by saying that the role of their security agencies was justified after the Mumbai attacks. However, the fact is that the Mumbai attacks took place in 2008, while the report was published in 2007.

Another adverse development was India's opposition to an EU concessionary package.

In 2010, Pakistan's economy suffered a severe jolt when heavy floods, described by the UN Secretary General as a "tsunami in slow motion," damaged crops and infrastructure, and caused considerable losses in human lives. The EU promptly announced a limited package to help Pakistan cope with the economic consequences of this catastrophe. The package had to go to the WTO for a waiver. A meeting of the WTO's Council for Trade in Goods (CTG) to discuss the package was held on November 29, 2010. I was in Geneva before the package was due for discussion, and requested a meeting with Mr. Das Gupta, India's ambassador and permanent representative to the WTO at that time.

I spent at least an hour in his office, and tried to explain that the package had no commercial consequences for India. If India was seen to be opposing this package, I said, it would further reinforce the negative perceptions of Pakistan's traders. He appreciated the points I was making, but when the package came up for discussion in the CTG, India promptly opposed it, as did some other countries.

Pakistan and India play cricket with a passion, and it so happened that the World Cup semi-final match was played in Mohali, India, on March 30, 2011. The Indian prime minister invited his Pakistani counterpart to watch the match. The Indian side agreed to Pakistan's request regarding the withdrawal of India's objections to the granting of the WTO waiver. The prime minister of Pakistan informed his country's private sector that the Indian prime minister had accepted his request. This was appreciated by all.

After the resumption of the Composite Dialogue, the 5th round of Pakistan-India commerce secretary-level talks took place on April 27–28, 2011, in Islamabad. Indian Commerce Secretary Mr. Rahul Khular appeared to be a serious and sincere person. He was pleased to know that even before the talks had started, the Ministry of Commerce in Pakistan had started a consultation process with the Chambers of Commerce and Industry to switch over from a positive list to a negative list for imports from India. The joint statement issued at the end of the two-day meeting established a working group dedicated to addressing and resolving sector-specific barriers to trade. It was decided that Pakistan would remove its restrictions on trade by land route as soon as the infrastructure in Wagah was ready. The scope of cooperation was expanded to include electricity, petroleum, cotton seeds, banking, visas, railways, and the integration of chambers.

More importantly, the joint statement mentioned that the granting of MFN status to India would help increase bilateral trade.

However, the normalization process was still not moving forward, as India had not withdrawn its objection to the EU package at the WTO. In July 2011, the EU informed Pakistan that the concessionary package would not be taken again to the WTO unless India gave its approval. This created widespread dismay within Pakistan's business circles, and the president of the Pakistan Federation of Chambers of Commerce and Industry wrote to his counterpart organizations in India to protest the move. Fortuitously, a helpful development emerged around this time: Mr. Anand Sharma, the minister of commerce and industry of India, who has a clear vision regarding trade normalization, took over the textile portfolio on July 12, 2011.

On the invitation of Mr. Anand Sharma, Pakistan's commerce minister visited India from September 26–30, 2011, and was accompanied by a strong business delegation. This was the first visit by a commerce minister from Pakistan to India in 35 years. The major outcome of this visit was the political ownership of the trade normalization process. Additionally, India unilaterally offered not to oppose the EU package at the WTO. The two ministers also agreed to:

a. Full normalization of trade relations
b. Dismantling of NTBs
c. Full implementation of obligations under the South Asian Association for Regional Cooperation (SAARC) Agreement on SAFTA

This visit created a conducive environment for Pakistan to move forward. The Ministry of Commerce arranged a detailed briefing for the Cabinet on November 2, 2011. The Cabinet unanimously endorsed normalization of trade relations with India, and directed the Ministry of Commerce to engage India toward a complete normalization of trade, culminating in the granting of MFN status to India.

The commerce secretaries of the two countries met on November 14–15, 2011, in India. The sequencing of trade normalization was chalked out, and it was decided that following a move to a negative list by February 2012, the negative list would ultimately be phased out by the end of 2012.

To allay the fears of Pakistani exporters, interactive sessions were arranged between Indian import regulators and private sector companies. The first one was held in New Delhi on September 29, 2011. Indian import regulators also visited Lahore and Karachi on January 25 and 27, 2012.

As had been agreed earlier, the negative list was finalized. One of Pakistan's premier business educational institutes, the Institute of Business Administration (IBA), was entrusted with the task of preparing the negative list. IBA, using its considerable professional and technical expertise, completed the task despite time constraints.

The 6th SAFTA ministerial meeting was held in February 2012. This coincided with the holding of the "Made in India" exhibition in Lahore, where large numbers of Indian exhibitors participated. At about the same time, following an invitation from his Pakistani counterpart, the Indian commerce minister—along with a business delegation—visited Pakistan from February 13–16, 2012. This marked the first-ever visit by an Indian commerce minister to Pakistan. The announcement of a switch-over from a positive to a negative list was to be made during this visit. However, the Indian delegation had to face some disappointment when the Pakistani Cabinet postponed consideration of the case. Ironically, this happened on Valentine's Day.

We could not give the appropriate gift of additional access to Pakistani markets to the Indian trade minister and his delegation. However, the two ministers agreed that when Pakistan notifies its negative list, India would reduce its sensitive list, per SAFTA strictures. Also, to allay the apprehension of Pakistani exporters regarding Indian NTBs, three facilitation agreements were initiated. These include customs cooperation, grievance redressal, and mutual recognition agreements. Pakistan had agreed in November 2011 to take the case to the Cabinet in February. On February 29, 2012, the Cabinet approved the switch-over from a positive to a negative list. Pakistan's credibility was saved. The Cabinet also approved a possible phase-out of the negative list by December 2012.

There are other positive signs on the horizon, including consensus among major political parties on trade normalization with India. The Special Committee of National Assembly on Kashmir and the Standing Committees of National Assembly and Senate on Commerce were taken on board, and have endorsed the road map for normalizing trade relations with India.

REMAINING AREAS OF CONCERN

Despite the progress made so far, there are still fears of India's economic dominance in the minds of the Pakistani private sector and political leaders. India has a huge trade balance in its favor with other SAARC countries, and a constant fear in the minds of analysts is that owing to a large industrial base and a restrictive import regime, the trade imbalance between Pakistan and India will further deteriorate.

There are suspicions about India's sincerity to make SAFTA work. India has two separate sensitive lists for least developed countries (LDCs) and non-LDCs in SAFTA. The Indian sensitive list for non-LDCs is almost Pakistan-specific, and restricts market access for Pakistani products.

Based on its past experience exporting to India, the Pakistani private sector complains of a non-cooperative attitude of import regulators in India, and expresses concern about the smooth operation of the three facilitation agreements. The Pakistani private sector fears that India will find ways to nullify the effectiveness of these agreements.

To make the trade normalization process sustainable, simultaneous progress in other tracks of the Composite Dialogue is highly desirable.

The move to normalize trade relations with India is a courageous decision taken by the government of Pakistan. Reversing this process would have serious implications, not only for the two countries, but for the region at large.

Because of its dominant economic position, India needs to be large-hearted and more accommodating toward its neighbors. Granting trade concessions to its smaller neighbors would not hurt it economically. It would not only earn goodwill and respect for India in the region, but would also contribute to the economic integration of South Asia.

India has recently revisited its investment regime, which has contained Pakistan-specific restrictions. Pakistan has no such restrictions. India still has specific restrictions regarding remittances to Pakistan, which cause difficulties for service providers of Pakistan in India. Hopefully, all such issues will be resolved in the not-too-distant future.

There are lobbies in Pakistan that believe that due to India's large industrial base and economies of scale, Pakistan's market will be swamped with Indian products that damage Pakistan's industry. The impression that trade liberalization with India is creating unemployment in Pakistan must be avoided at all costs, in order to prevent a political and social backlash and to make the process sustainable.

Although the trade normalization process between the two countries is bilateral, the entire world has a stake in peace in South Asia.

The *Economist*, in a lead article and cover story in its May 19, 2011 issue, asked the world to contribute to the normalization of relations between the two nuclear-armed countries.[2] Japan is in a unique position to help, due to its dominance of the auto sector in Pakistan and India. As Honda, Suzuki, and Toyota are present in both countries, Japan can persuade its companies in Pakistan not to import everything from India, and to source parts from sister companies in Pakistan. For example, Pakistan can import Suzuki CKDs from India, while Corolla can be exported from Pakistan to India. In this way, Japan can help create interdependence between the auto sectors of both countries.

Slowly and gradually, the attitude of the Pakistani private sector regarding trade with India has started to change. We need to nurture this process to make trade normalization between the countries irreversible.

In 2011 and 2012, I visited all the major chambers and trade associations repeatedly to explain the normalization process to the private sector. Pakistan's commerce minister engaged the services of Dr. Manzoor Ahmad, Pakistan's former ambassador to the WTO, along with a team of others, to conduct a series of seminars (from April 3–26, 2012) in all major cities of Pakistan to educate the private sector about the Indian import regime.

We also arranged an exhibition, entitled "Lifestyle Pakistan," in India from April 12–15, 2012. Pakistan's commerce minister was present in India during this exhibition, and was accompanied by a trade mission of more than 100 businessmen.

Despite all these efforts, there are still many in Pakistan's private sector who remain unconvinced and deeply apprehensive about doing business with India. Admittedly, I have appeared on talk shows on television, and faced tough questions to explain the need for trade liberalization.

ENCOURAGING SIGNS

There is a generally held belief about the role of Pakistan's security establishment. Most people think that it is against normalization of trade relations with India.

On the contrary, Pakistan's security agencies have never interfered with imports from India. This has also been confirmed by Dr. Taneja in the aforementioned ICRIER report:

> The identification of trading firms was relatively simpler in the survey conducted in Pakistan than in India. Unlike the Indian survey, none of the traders denied trading with India and discussions were held in a free and open manner. In addition several members of the FPCCI and the Chambers of Commerce interested in trading with India volunteered to give interviews.[3]

This is further validated by the fact that Pakistan's trade relations with India were on an MFN-basis under military governments, which were in power starting in 1958. Bilateral trade thrived during those periods.

Additionally, as commerce secretary, I can say with all honesty that during this normalization process, no one from the security establishment has ever contacted me to even discuss this issue.

We all have our own perceptions. However, we generally tend to underestimate the role of the private sector in shaping public opinion. When the private sector felt that India was not sincere in establishing business relations with Pakistan, there was little progress. When this perception began to change, we covered a lot of ground within a short period. The essence of this argument is that the private sector is, and will remain, the main driver of business relations between the two countries, something that has now been realized by both sides.

I only hope that the U.S. administration will learn a lesson from this experience. Reconstruction Opportunity Zones (ROZs), which have been on the drawing board for the last few years, remain unimplemented. The inability of the United States to move forward with this program has created serious misgivings among the people of Pakistan. The implementation of ROZs should be a key policy initiative to support our joint efforts to build bridges of understanding between our people.

In the early 1960s, Pakistan's second five-year plan enabled its economy to grow at a fast pace. In fact, the World Bank sponsored a delegation from South Korea to study the growth model of Pakistan. Back then, Pakistan's economy was thriving in a rather peaceful region. It was regionally well connected. But after Pakistan's war with India in 1965 and then the Soviet invasion of Afghanistan in 1979, everything changed.

Our government has declared 2012 as the "year of regional trade and connectivity." We hope that the situation in Afghanistan stabilizes, and opens up new opportunities for Pakistan (and India) in Central Asia.

The distance of Kashghar (the capital of Xinjiang province in China) from Karachi's port on the Arabian Sea is only 1300 miles. The distance of Kashghar from the port of Shanghai is twice as far. It makes economic sense for exports and imports from Kashghar to be routed through Karachi. Pakistan has an all-weather road link with China, which has been slightly disrupted due to an earthquake-generated lake in the Attabad region of Pakistan. However, this is being addressed through the construction of an alternate route to skirt around the lake.

Pakistan's trade with India is expected to gain momentum, especially if there is movement on other bilateral issues holding up an improvement in political relations. If this happens, the stage will be set for a well-integrated SAFTA region that would, both economically and commercially, integrate with the neighboring ASEAN region. For Pakistan, this would be the time to finally take advantage of, rather than suffer from, its geo-commercial location.

ENDNOTES

1. Nisha Taneja, "India Pakistan Trade Possibilities and Non-tariff Barriers," working paper No. 200, Indian Council for Research on International Economic Relations (ICRIER), New Delhi, October 2007, http://www.icrier.org/pdf/Working%20Paper%20200.pdf.
2. "The World's Most Dangerous Border," *Economist*, May 19, 2011, http://www.economist.com/node/18712525.
3. Taneja, "India Pakistan Trade Possibilities and Non-tariff Barriers."

Pakistan's Trade with India: Thinking Strategically

IJAZ NABI

On February 29, 2012, Pakistan granted India Most Favored Nation (MFN) status, paving the way for a normal, World Trade Organization (WTO)-consistent trade relationship between the two largest economies of South Asia. (India granted MFN to Pakistan in 1996.) It would be a mistake, however, to take for granted sustained trade growth following this announcement. Pakistan-India relations are complex and many factors can intervene to disrupt the smooth flow of trade and other economic transactions. This essay[1] argues that Pakistan, but also India, has to take a strategic, regional approach in managing its trade and economic relationship with India to prevent future disruptions in trade and thus maximize the benefits of this important announcement.

BACKGROUND

Before 1947, the regions constituting Pakistan and India had been part of a large, well-integrated economy, and for centuries people, money, and goods had moved unimpeded between the regions. This routine exchange was given a new vigor in the century leading up to 1947, when canal irrigation, transport networks, and a newly established legal framework unleashed market forces on an unprecedented scale.

Following partition (and independence from colonial rule) in 1947, despite the violence and transfer of populations, deep economic

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Ijaz Nabi is a visiting professor of economics (and former dean) of the School of Humanities, Social Sciences, and Law at Lahore University of Management Sciences (LUMS).

complementarities continued to assert themselves, and India remained Pakistan's most important trading partner. It is important to note that trade continued even during the first India-Pakistan war over Kashmir in 1948. In 1949, half of Pakistan's exports were sent to India (especially agricultural produce and minerals), and 32 percent of its imports (mainly manufactured goods) were from India.

In recognition of these geography- and history-anchored trade/economic complementarities, GATT (Generalized Agreement on Tariffs and Trade, the precursor of WTO), of which both Pakistan and India were founding members, inserted an India-Pakistan specific clause in the 38 Articles governing international trade (Article XXIV, clause 11):

> Taking into account the exceptional circumstances arising out of the establishment of India and Pakistan as independent states and recognizing the fact that they have long constituted an economic unit, the contracting parties agree that the provisions of this Agreement shall not prevent the two countries from entering into special arrangements with respect to the trade between them, pending the establishment of their mutual trade relations on a definitive basis.

It would be easy to conclude that the clause allows Pakistan and India to continue to enjoy a close bilateral trading relationship not extended to other GATT members, because they were an economic union until 1947. This interpretation would be consistent with the overall trade liberalization spirit of the GATT framework.

The fact, however, is that disagreements between the two countries were laying the basis for a completely different interpretation of the clause.

Difficulties in the Pakistan-India trade relationship surfaced in 1949. In anticipation of a commodity price boom, Pakistan (an exporter of cotton, jute, and wheat) did not match India's decision to devalue its currency. India objected to this strongly, arguing that this would increase the cost of raw materials (primarily jute) imported from Pakistan, and imposed an import duty on jute. A deadlock ensued, disrupting, for the first time, trade between the two countries.

In his budget speech to the parliament in Karachi on March 13, 1950, Pakistan's Finance Minister, Ghulam Mohammad, said:

> I regard it as highly unfortunate that instead of facilitating the normal flow of trade between the two countries, the Government of India should have embarked on a boycott of trade with us. While fixation of the rate of currency is entirely a question for each country to decide with reference to its circumstance, trade is a matter of prices. India, however, has taken the extra-ordinarily unfriendly step of boycotting trade with us. Judging from the fact that our trade with other countries continues to flow freely, I am led to the conclusion that India's action is motivated by political rather than economic considerations. This is in line with a series of unfriendly actions in the economic and financial fields that [India's] Government has taken against Pakistan since partition.[2]

Such perceptions about India's "intentions," along with a rapid improvement in reserves following the commodity price boom from the Korean war (1950–53), presented Pakistan's economic managers with the opportunity to launch a new development strategy. Following the trade deadlock, restrictions on the import of Indian manufactured goods was an important element of the import substituting industrialization strategy that created a strong industrial base in Pakistan. And the strategy delivered results. For three decades, Pakistan's manufacturing sector grew at double-digit rates and helped spur average annual gross domestic product (GDP) growth of over 6 percent. This created a strong industrial lobby in Pakistan that would become highly influential in shaping the country's trade policy, including trade with India.

The wars of 1965 and 1971 and the Kashmir revolt in the 1990s introduced a military tactical dimension to the flow of trade between the two countries. Trade was severely disrupted and never really recovered. In Pakistan, the debate on resumption of trade was put to the impossible test of "improvement in ground realities." Indeed, Pakistan persuaded GATT to interpret clause 11 of Article XXIV in a manner completely opposite of what had been intended—i.e., as a GATT sanction to maintain a restrictive trade regime vis-à-vis India even as Pakistan liberalized trade with the other GATT members.

Given this history, Pakistan and India will need to work hard to avoid the pitfalls that might disrupt trade flows in the future, reducing the benefits associated with a more liberal trade and economic regime between the two countries.

A STRATEGIC APPROACH TO TRADE WITH INDIA

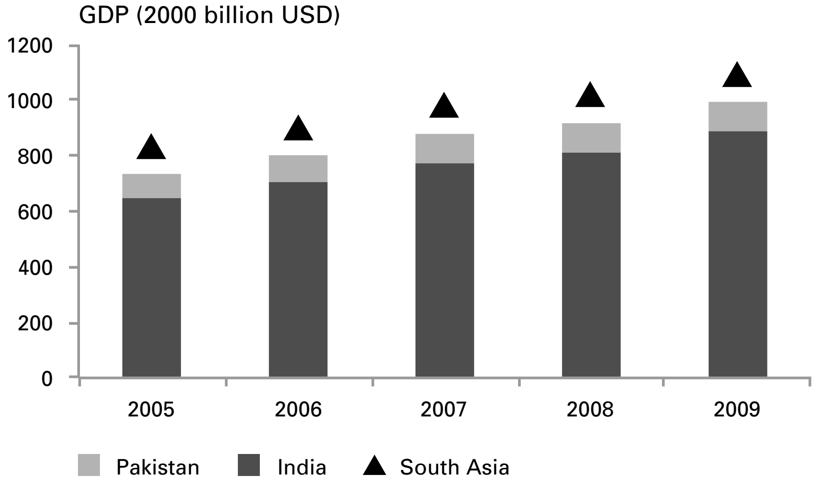
Regional trade, of which trade with India is a key component, has to be seen in the context of Pakistan's overall economic growth objectives. Pakistan needs economic growth of 7 percent or more for the next four decades. This is just one percentage point higher than the growth rate Pakistan has achieved in several decades in the past, and only two percentage points higher than the average growth rate since 1947. Sustained growth at these rates will double GDP every 10 years, will result in a substantial improvement in living standards within a generation, and will engender a sense of optimism in the citizenry.

But there is an important caveat. Pakistan needs a growth vent (source of growth) that is geographically balanced and thus can be sustained politically. Furthermore, the growth vent Pakistan seeks requires tapping into lucrative markets outside its borders in a manner that creates several growth nodes—a southern and western node (Karachi, the Arabian Sea coastline of Sindh and Baluchistan), a central node (Multan, Lahore), and a northern node (Peshawar, Abbottabad). A liberalized economic relationship between Pakistan and India and other neighbors (Iran, Central Asia, and China) can help achieve a high growth rate that is regionally balanced, and can therefore be sustained for a longer period than Pakistan has ever achieved in the past.[3]

Seen in the context outlined above, the current state of trade between the two largest South Asian economies is not encouraging. Pakistan and India account for most of South Asia's regional GDP (nearly 90 percent; see Figure 1). Yet direct trade between the two largest regional economies is almost nonexistent. Figure 2 shows that in 2009, combined world-wide trade for India and Pakistan was \$462 billion, while their bilateral trade was a mere \$1.7 billion. While a more conducive trade regime with all regional neighbors is important, the critical area of focus for Pakistan is its trade and broader economic relations with India.

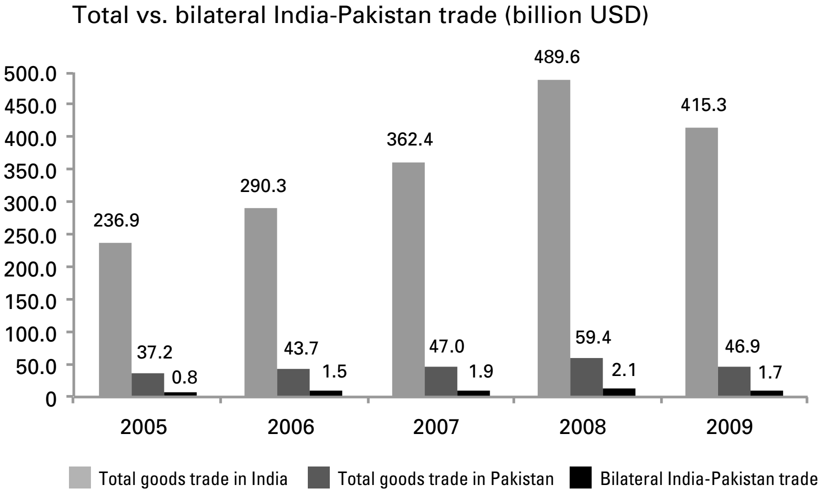
Trade relations between India and Pakistan have been difficult in the past because the two countries have viewed each other through a

Figure 1: India, Pakistan, and South Asia GDP



Source: World Bank, World Development Indicators, 2011.

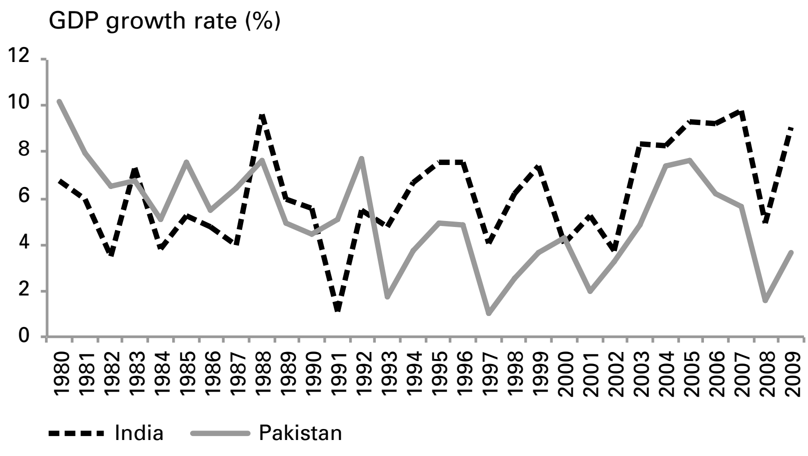
Figure 2: India-Pakistan Total and Bilateral Trade



Source: World Bank, World Development Indicators, 2011; *UN Commodity Trade Statistics Database (Comtrade), 2010.*

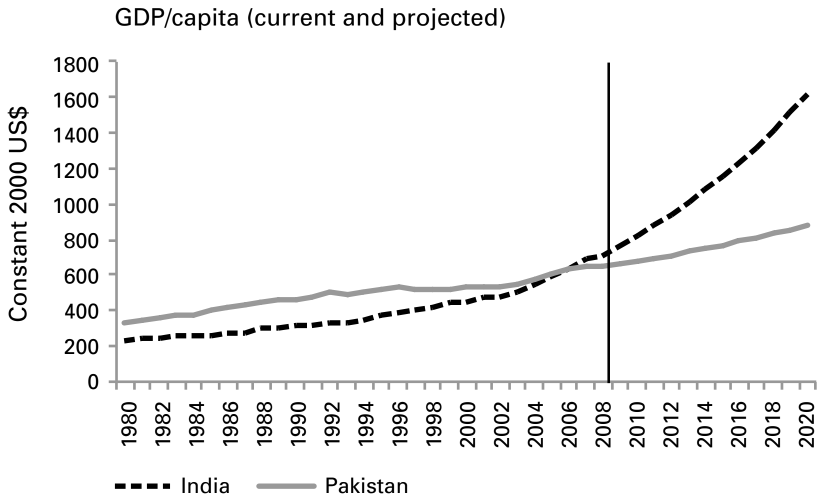
geopolitical lens, and not as potentially vibrant trading partners. This outlook has to change. Pakistan in particular needs to recognize that India is no longer confined to a low "Hindu rate of growth," but is a rapidly modernizing economy that is increasingly integrated with the world economy in a way that could have strong spillover benefits for Pakistan. India's recent GDP growth rate averaging 8 percent is more than twice Pakistan's (see Figure 3). And because India's population growth is lower, per capita income in India is growing even faster (see Figure 4). This divergent economic performance has several implications (see Table 1). One is that in the not-too-distant future, living standards, including the quality of infrastructure and public services, will be better in India. Significantly, India will also have a larger lobbying presence in international forums, which will have consequences regarding Pakistan's ability to maintain parity across a broad range of contested and competing issues. Further, India's capacity to modernize its security establishment will be far greater than Pakistan's.

Figure 3: GDP Growth in India and Pakistan



Source: World Bank, World Development Indicators, 2011.

Figure 4: Current and Projected GDP Per Capita in Pakistan and India (in the Absence of a Pick-up in Pakistan's Growth)



Source: World Bank, World Development Indicators, 2011.
Note: The projections have been done using growth rates averaging over the last five years.

Table 1: Sobering Trends

	2006	2020
Pakistan's GDP as share of India's GDP	14 percent	9 percent
GDP per capita in Pakistan as percentage of India's.	99 percent	54 percent
$ value of one percent GDP spent on public services in India	$7 billion	$22 billion
$ value of one percent GDP spent on public services in Pakistan	$1 billion	$2 billion

Source: World Bank, World Development Indicators *(various years) and author's own calculations.*

The key question for Pakistan is how it can turn India's growing economic capability to its own advantage and thus bridge the income gap, and then overtake India's growth rate—as it did in the 1960s and 1970s. This is not as ambitious as it might seem when looking only at the current performance of the two economies. As Figure 3 shows, in most years in the 1980s, Pakistan's GDP growth was higher than India's. Furthermore, even now, Pakistan ranks higher than India on many indicators of the cost of doing business (Table 2). Thus a solid foundation already exists to build a mutually beneficial economic relationship with India.

A historical perspective is useful to appreciate that a liberal economic relationship with India would be a source of economic growth for Pakistan.

The regions that comprise Pakistan have enjoyed five major growth vents in the last 100 years that have contributed to improving living standards. The first growth vent, lasting nearly half a century, was the construction of canals in the Indus basin that brought about long-lasting changes in the design of institutions, locations of populations, and modes of exchange that now constitute the core structures of the economy. Four subsequent growth vents were experienced following Independence in 1947. The first was the Korean War boom that has had a deep impact on how Pakistan has managed the economy. (The exchange rate policy and preference for consumption over savings and investment can be traced back to this commodity boom.) The second was import-substituting industrialization that produced rapid growth in the 1960s (but growth that could not be sustained). The third was the green revolution technology that resulted in robust agricultural growth in the 1970s and 1980s. Finally, overseas migration and the resulting remittances that have spurred growth for the last 30 years have been the most recent growth vent.

Each of these growth vents has contributed significantly to increasing living standards, but these sources of growth have now been exhausted. The economy is thus poised for a new growth vent. The consensus view of the business community in Pakistan (as expressed by the Pakistan Business Council) is that regional trade would constitute such a growth vent. However, the full benefits of this source of growth will not be realized without the resumption of trade and broader economic relations (skills, technology, and investment flows) between India and Pakistan. Significantly, such a growth vent would also bring about more regionally balanced growth within Pakistan (see Box 1 below).

Table 2: Investment and Cost of Doing Business Indicators (2010)

Indicators	Pakistan	India
Trade: Cost to export ($ per container)	611.00	1055.00
Trade: Cost to import ($ per container)	680.00	1025.00
Trade: Time to import (days)	18.00	20.00
Ease of doing business index (1=easiest to 183=most difficult)	83.00	134.00
Cost to start a business (% of income per capita)	10.70	56.50
Time required to start a business (days)	21.00	29.00
Procedures required to start a business (number)	10.00	12.00
Total tax rate (% of profit)	31.60	63.30
Profit tax (%)	14.30	24.00
Other taxes (%)	2.30	21.10
Tax payments (number)	47.00	56.00
Time required to enforce a contract (days)	976.00	1420.00
Cost to enforce a contract (% of claim)	23.80	39.60
Procedures required to build a warehouse (number)	12.00	37.00
Closing a business: cost (% of estate)	4.00	9.00
Closing a business: recovery rate (cents on the dollar)	36.50	16.30

Source: World Bank, Doing Business 2010 Reforming through Difficult Times, *2009.*

BOX 1: Regional Trade Beyond the Borders to Promote More Regionally Balanced Trade Within the Border: A Historical Perspective

Historically, the regions of Lahore, Peshawar, and upper Sindh were connectors of the lands to their west—Iran, Central Asia, and China—and those to the east—India—and as such became centers of trade, commerce, and culture. This flourishing activity made them growth nodes that brought prosperity to their surrounding regions.

Lahore in Punjab was the center of trade, commerce, finance, and education for a region that included Indian Punjab, Haryana, Jammu and Kashmir valleys, and Himachal Pradesh to its east, and linked these regions with Persia and Central Asia to its west. Lahore was cut off from the West with the coming of the British and from the East soon after 1947.

The ancient walled city of Peshawar has cast a huge and disproportionate shadow on South Asia's culture. The prominence of Peshawar is on account of the fact that the merchants of the walled city constituted a prosperous hub of economic transactions between South Asia and the Central Asian territories. The civilizing influence of trade on the surrounding Pashtun areas would also have been substantial. Imperial rivalry between Russia and Britain cut off Peshawar from its northern markets, and 1947 severed access to the Indian markets. The pool of economic transactions for Peshawar shrank dramatically. It is also noteworthy that the modern silk route through Hazara and Gilgit Baltistan on to China is an attempt to reproduce the ancient trade links that were severed during colonial times.

Sindh is hugely significant in shaping our religious/cultural psyche embedded in the venerated Sufi tradition of Islam. The Sufi saints chose to settle in Sindh along the Indus because there were receptive host communities that were benefiting from the trade routes between markets in territories that now lie in India and Iran through Baluchistan.

These cultural centers have defined themselves historically based on a pattern of economic transactions, trade routes, and cultural influences, as parts of much larger regions that lie outside the borders of the modern nation state of Pakistan. A liberalized regional trade regime, especially one between India and Pakistan, will help restore the vibrancy of all three major economic/cultural centers of Pakistan, and thus would contribute significantly to the objective of regionally balanced growth.

Source: Ijaz Nabi, India-Pakistan Relations: An Economist's Peek into the Future *(Lahore: South Asia Free Media Association, 2010).*

KEY ISSUES TO BE ADDRESSED

Post-Liberalization Trade and Investment Volumes

Gravity models predict that with the resumption of normal trade, the 2009 Pakistan-India trade volume of $2 billion could be 5 to 10 times larger.[4] However, gravity models do not adequately capture the complex relationship between Pakistan and India that would come into play with the resumption of normal trade. On the one hand, there is historical and cultural similarity and, on the other, there are grievances and grudges. Recently, the Pakistan Business Council's (PBC) regional trade group (comprised of businessmen, academics, and civil servants) conducted a survey of perceptions within the group. The range of perceived trade flows following liberalization is reported in Table 3.[5] The longer term perceived impact (after about 10 years of liberalization) is significant.

However, in order for trade flows to realize their full potential, investment flows must also be on the normalization agenda. An influx of investment will be good news for Pakistan, as it currently needs capital inflows to

Table 3: Pakistan Business Council (Regional Trade Group Members) Perceptions on Likely Trade and Investment Flows Following India-Pakistan Liberalization

	Trade Volume	Investment Flows into Pakistan	
		By Pakistanis	By Indians
Short-term	$1–5 billion	Substantial increase	Sustained increase of more than $1 billion a year
Medium-term	$10–20 billion		
Long-term	$15–50 billion		

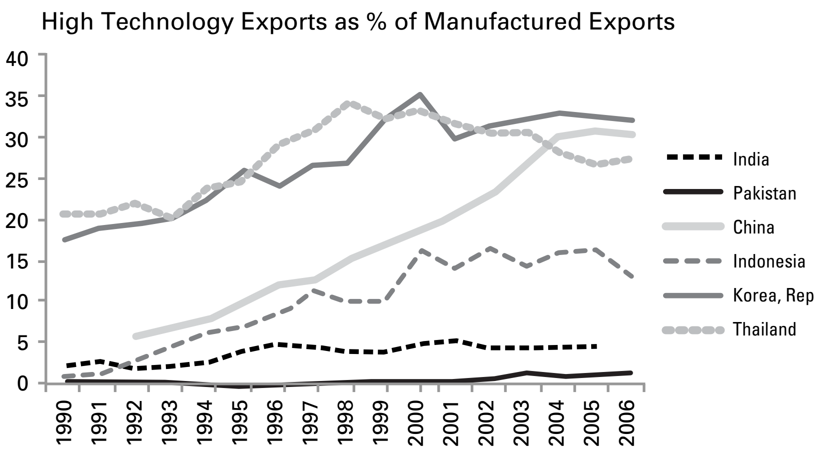
move to a higher growth trajectory. India, being right next door and with a large pool of savings, would be a promising source of investment. Three-fourths of the PBC panelists agreed that investment flows by both Indians and Pakistanis, following trade liberalization, will increase in volume. Hence it is not only the Pakistani economy that would benefit from bilateral investment flows; India also stands to gain. As compared to their home country, Indian investors will find in Pakistan an environment much more conducive to economic activity (see Table 2). The assumption, of course, is that law and order in Pakistan will have improved significantly.

Joint ventures of Pakistani and Indian investors can be visualized in the old trading centers of Peshawar, Lahore, and Sindh, taking advantage of plentiful Pakistani labor, lower transportation costs (from Peshawar to the Central Asian markets, and from Karachi and Gwadar to the Gulf and Middle East markets), and Pakistan's extensive infrastructure along the North-South Corridor (linking Peshawar, Lahore, and Karachi).

Tapping into India's Knowledge Economy

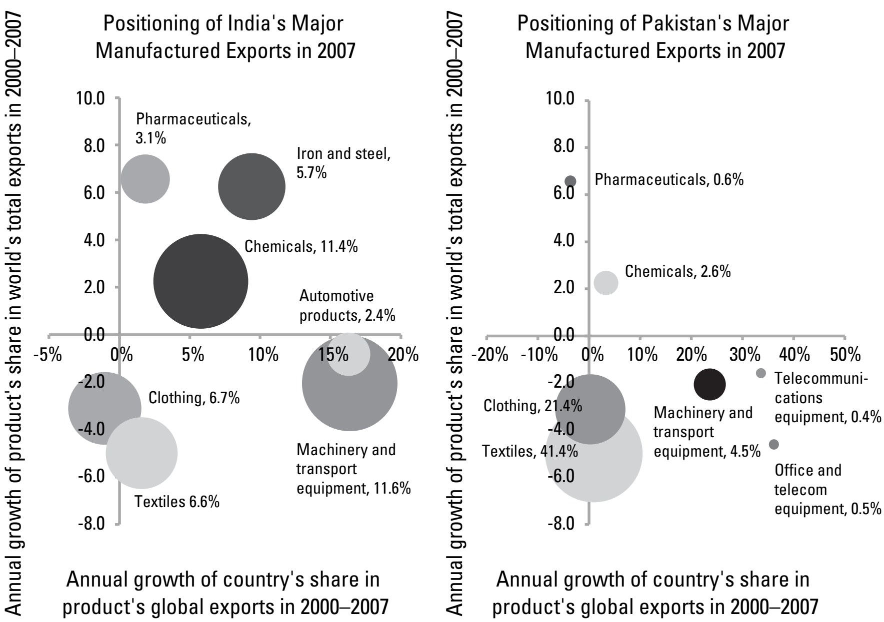
India is now reaping the benefit of shrewd investment in higher technical education and is positioning itself as a knowledge economy. This is best evidenced in its phenomenal success in the IT sector. India now

Figure 5: International Competitiveness of Manufactures Exports



accounts for 60 percent of global outsourcing in this sector (exports of computer and business services in 2008 were estimated at $52.3 billion). Indian manufacturing, though not nearly as competitive as China's, is beginning to gain strength in the international market. This is seen in Figure 5 in terms of the share of high technology exports in total manufactures exports. Figure 6, capturing three dimensions of manufactures exports, shows India's emerging competitiveness compared to Pakistan's more clearly. India has three manufactures groups in the northeast quadrant (chemicals, iron and steel, and pharmaceuticals), while Pakistan has

Figure 6: Recent Performance of India and Pakistan Manufacturers Exports



Note: The northeast quadrant in Figure 6 measures a country's share in the export of goods (horizontal axis) whose share in total world exports (vertical axis) is rising. The size of the circle measures the share of that export in a country's total exports. Thus the larger the number of exports in the northeast quadrant and the larger the size of the circle representing each export, the more competitive is the country in the international market.

only one (chemicals), and that too is a much smaller share of Pakistan's overall exports compared to the share of chemicals in India's exports. Furthermore, India has an impressive network of agricultural research. A liberal trade and investment regime will allow Pakistan to tap into the pool of Indian skilled workers and technology to improve international competitiveness of Pakistani firms. Testimonials by industry specialists presented in the 2011 Pakistan Business Council report emphasize the spillover benefits of liberalizing trade and the broader economic relationship with India in a host of manufactures such as pharmaceuticals, automotive parts, textiles, and rubber, but also for agriculture. The spillovers manifest themselves in terms of access to raw materials, plants and equipment, India's research networks, project management experience, and supervisory work forces.

Non-Tariff Barriers

There is a widespread perception in Pakistan that the Indian trade regime includes a long list of non-tariff barriers that adversely affect trade volumes despite a statutory liberal tariff regime. This is offered as the principal reason why India imports little from Pakistan despite having given Most Favored Nation status to Pakistan unilaterally. The biggest non-tariff barrier in trade flows, of course, is poor trade logistics and visa restrictions that hamper businessmen from travelling across the border to strike trade deals. These non-tariff barriers are the result of poor security relations between the two countries, and need to be revisited if trade is to take place on a meaningful scale.

Non-tariff barriers are also justified for health and safety reasons, and there is evidence that the Indian trade regime includes such barriers in its protectionist arsenal. The extent to which these barriers are protectionist and harmful to regional trade needs to be investigated. Pakistan should use this opportunity also to examine its own trade regime for similar trade-retarding measures.

Anti-dumping measures are another form of non-tariff barrier, especially when they are invoked by monopoly producers of intermediate materials. There is evidence that the Indian trade regime uses anti-dumping measures to protect large Indian manufacturers. However, this is not a Pakistan-specific tactic. Furthermore, the use of anti-dumping is on the rise in Pakistan also for the same purpose—i.e., to protect monopoly/oligopoly producers of intermediate goods. As in India, such protection raises the production costs of downstream small and medium-sized firms. The use of anti-dumping to protect local monopolies lowers welfare gains from trade and must be reviewed for its efficacy.

Gainers and Losers from Trade with India

A number of studies[6] have carried out careful analyses of gainers and losers from liberalizing trade with India. The studies conclude:

- Pakistani consumers will be unequivocally better off as seasonal price hikes will be brought under control via access to a much larger market. Costs of most consumer products will fall and the variety available will increase. It will also help moderate inflation, which affects the poor disproportionately and contributes to political instability.
- Farmers will benefit from exchanges on technical know-how, since the benefits of such exchanges can be easily conveyed across our long common border. This will help boost farm productivity and lower costs of production for Pakistani manufacturers, making them more competitive internationally. Furthermore, rural incomes will rise, which will help lower rural poverty and ameliorate political tensions in the rural areas.
- Small manufacturers will be able to enjoy potential sub-contracting arrangements with larger Indian manufacturers, which will help increase their efficiency. Pakistan's industrial clusters of small manufacturers in Sialkot, Gujranwala, Gujrat, Faisalabad, and Hyderabad will be the chief beneficiaries, enjoying scale advantages of producing for a much larger South Asia-wide market.
- Some large-scale manufacturers who enjoy monopoly power in the Pakistani market and are subsidized by the government will be adversely affected in the short run. On the other hand, more dynamic producers will become more competitive,

which will boost Pakistan's exports in the international market. Liberalization will also allow commodities apart from textiles to enter into the trade mix, providing sectors other than textiles an opportunity to grow.

- Lastly, the government will be better off because legalized trade will generate tax revenues now lost to smuggling.

The best way of compensating any losers from a change in the trade regime with India entails the use of fiscal instruments. Government revenues, enhanced via tariffs on normal trade with India but particularly importantly, a modern consumption tax (such as the valued added tax, or VAT, or the improved generalized sales tax) levied on legalized trade with India, would generate the revenues for financing compensation measures.

National Security and Stop-Go India-Pakistan Trade

Economic liberalization with India may help allay security concerns that have prevented trade from flourishing. Opening up trade and two-way investment flows will create stakeholders on both sides of the border who will lobby for keeping the overall relationship between India and Pakistan on an even keel. The Pakistan Business Council estimates that trade volumes in the range of $10 to $15 billion will be the tipping point, making the gains from trade large enough for economic well-being to outweigh geostrategic preoccupations.

SAFTA, ECO, China, and Pakistan

The calculus of costs and benefits of liberalizing bilateral India-Pakistan economic relations pales in comparison to the potentially huge benefits of seeing that opening in the context of Pakistan's international role, given its location as the connector of regional powerhouses.

The resource-rich ECO (the Economic Cooperation Organization, comprising Central Asia, Iran, and Turkey) and manpower-rich South Asian Free Trade Area (SAFTA) are naturally complementary regions. Together they can turn this land of nearly 2 billion people into an economic power and reclaim its historical position as a cultural hub. Pakistan

BOX 2: The New (Old) Road to Kashmir

The time is ripe to take a new—and yet familiar—road to Kashmir. This road would be built on the solid foundations of economic geography and trade.

The high valley of Kashmir drains into northern Punjab via rivers and "nullahs" (a ravine or gully). Clinging to the contours of the drainage system are land routes that have facilitated the movement of people and goods for centuries. This has evolved into an intricate network of commercial and social "biradaries" (kinship-based networks) that bonds northern Punjab and Kashmir, and has facilitated the outflow of Kashmiris from the resource-poor valley into the plains. The new strategy must re-establish this network.

This can only be done through unbridled trade with India across the entire length of the international border and the Line of Control [LoC]. We are committed to this in the SAARC [South Asian Association for Regional Cooperation] agreements. Let us hasten it forward.

Trade with India can only do good. Consumers will benefit unambiguously. Some powerful protected manufacturers will be hurt, but they have enjoyed super profits long enough. Let them now compete. Many will see India as an opportunity to enjoy scale economies that a large middle class offers. Agriculture will benefit from the more advanced crop technologies across the border.

A liberal trade regime will promote greater travel. We will see, first-hand, the historical evidence of the grandeur of Muslim rule in India and visit the *dargahs* (shrines) of sufi-saints. The Sikhs will travel to Hasanabdal, Nankana, and Lahore to pay homage to their history and religion. An elderly generation of Punjabi and Sindhi Hindus in India and Northern Indian Muslims in Pakistan will fleetingly re-capture the *gali-koochas* (street-lanes) of their youth. How can this be bad?

And if commerce and people begin to move freely along the old trade routes across the LoC and re-create traditional networks, who will be able to tell where "Occupied" Kashmir ends and "Azad" Kashmir begins?

A liberalized trade regime could easily see India-Pakistan trade jump to \$2-\$3 billion and much larger in the medium term. Powerful commercial lobbies in Delhi, Lahore, Bombay, and Karachi will then ensure that no one tramples on the rights of Kashmiris to trade, fraternize, and prosper—be they Muslim, Hindu or Buddhist. How could this be bad?

Source: Ravian (Ijaz Nabi), "The New (Old) Road to Kashmir", Daily Times, *September 13, 2002.*

enjoys the unique location advantage as a connector of the two regions. As things currently stand, Pakistan is on the periphery of SAFTA, and India plays the role of connecting the SAFTA economies and enjoys the benefits that accrue. The natural economic alliance of SAFTA and ECO will shift the role of the regional connector to Pakistan, along with all the economic benefits that are associated with this role.

Pakistan's role as a connector of regional economies gets a further fillip from the fact that our location allows us also to connect SAFTA and ECO to the other regional powerhouse, China. Thus our geographical location, supported by a sensible geopolitical strategy and complemented by investments in skills and infrastructure, and by trade policies that support the facilitation of regional trade rather than protect local monopolies, will open up economic opportunities on a scale we cannot even imagine in our current economically confined state. Box 1 shows that we have historically enjoyed this role, and highlights the benefits that come from it.

RECOMMENDATIONS FOR PAKISTAN

Regional Trade

Redefining the national security paradigm: The greatest threat to national security now comes from violent internal dissention rooted in economic depravity. Economic well-being and the promotion of regional trade that will rejuvenate economically deprived border areas should therefore be the cornerstone of the new national security paradigm.

Improving internal governance: Improving the internal law and order situation, which includes eradicating violent militant groups as well as protecting property rights and boosting overall governance, must be a core element of the new national security paradigm.

A supportive trade policy: Given the strategic role Pakistan has to play as a connector of trade between three vibrant regions of the world, its trade policy has to be agile and forward-looking. A recent review of trade policy carried out for the Planning Commission shows that it lacks strategic focus and that the policymaking environment is in need of thorough reform.[7] Pakistan's trade policy has to move away from protecting local monopoly interests focused on our small internal market to facilitating regional trade. This will require a much more strategic trade policy and, in turn, will need more skilled personnel and better functioning institutions to design and implement the policy.

The role of the National Tariff Commission in particular needs to be examined. It must move away from initiating anti-dumping proceedings at the behest of those who seek costly protection (thus creating roadblocks to the flow of trade) to building up the capacity to quickly reject bogus complaints of dumping.

Develop a strategy for transit trade: To enjoy the full benefits of trade and investment flows between China, Central Asia, Iran, and India, a comprehensive strategy for promoting transit trade corridors must be developed, including the capability to process goods.

Supportive infrastructure investments: Investment will be needed to upgrade infrastructure that includes road/railway networks and move to state-of-the-art trade facilitation (customs clearance, warehousing). Public-private partnerships (including investors from regional trading partners) should be harnessed to build the infrastructure cost-effectively.

Conducive financial services: The regulatory framework must be fine-tuned so that banking and other financial services can play their proper role of lubricating regional trade and facilitating investment flows.

Specific to Trade with India

Timing: Liberalizing the economic relationship with India takes on greater urgency with the passage of time, if Pakistan is to enjoy its current entry-point comparative advantage in the cost of doing business, and especially its advantage in infrastructure efficiency. This advantage will be eroded as India reduces business costs and improves its infrastructure. Had Pakistan liberalized 20 years ago, it would have enjoyed the entry-point advantage of a much better overall investment climate that is eroding over time.

MFN status: The long and unwieldy negative list of 1200 items that accompanied the announcement of the India MFN status must be eliminated within the year as proposed. MFN status to India must be accompanied by setting up a bilateral commission to address the issues that are closely tied up with India and Pakistan having a normal economic relationship that results in sustained benefits. The commission would focus on:

> **(i) Goods and services-related non-tariff barriers**: Use the WTO framework for addressing Indian (and Pakistani) non-tariff barriers, and then bring these into the strategic regional trade policy framework outlined above. Develop institutional capacity (National Tariff Commission) to address non-tariff barriers and anti-dumping complaints with a view to promoting trade rather than hindering it.
>
> **(ii) Land routes:** The maximum benefits from a more liberal trade regime with India will come from land routes that minimize response time to market forces. Open up as many land routes as possible, building on the old road and railway networks all along the border from the Kashmir region to the Arabian Sea.
>
> **(iii) Travel:** Travel (visas, air/road/railway transport) must be facilitated to promote competitive trade in goods and services that benefits small and medium-sized firms, to tap into the large pool of Indian skilled workers, gain access to Indian farm and other technology, and encourage cross-border tourism.

Cross-border investment flows: The regulatory framework must facilitate cross-border investment flows rather than hinder it.

Proactively address the trust deficit to prevent stop-go cross-border trade: To create sustained momentum for liberalizing trade and investment flows, set up a regional trade forum (comprising the private sector, academia, and the media) that monitors the working of the bilateral commission mentioned above. The forum should identify barriers to trade embedded in the trade policy, the payment system, and communications (including travel). The forum should also help identify losers from liberalizing trade with India, and suggest ways to compensate them, and should help in formulating a broader regional trade and investment promotion strategy.

Initiatives like *Aman ki Asha* (a campaign promoting mutual peace and the development of diplomatic and cultural ties between Pakistan and India, initiated by the Jang Group and the *Times of India*) have the capacity to build large constituencies for healthier India-Pakistan relationships. Such efforts should be encouraged as part of the strategy to move toward a more orderly transition to a liberalized economic relationship with India.

INDIA'S ROLE IN PROMOTING BILATERAL AND REGIONAL TRADE[8]

All paths to economic development and prosperity do not have to be routed through sweatshops catering to affluent western consumers. A large and vibrant Asian regional market would constitute a significant and, given demographic shifts, growing part of global demand for products. India's long-term strategic interest is to help create that Asian market. That, in turn, requires strengthening Pakistan to be an effective regional hub that connects the Asia-wide market.

Successful management of the new liberalized India-Pakistan trade regime to scale it up to a full-fledged economic relationship will be key. In the short-term, it may well mean exercising voluntary restraint on exports that hurt small and medium-sized Pakistani manufacturers. It would also require focusing on the export of machinery and technology to Pakistani firms that currently import these at high cost from more expensive developed country sources. Joint ventures and other investment strategies would need to be developed to set up production units for the Asia-wide market. The visa regime will have to be liberalized and travel facilitated, so that small entrepreneurs develop cross-border business linkages and gains from liberalization are shared more widely.

Above all, an Indian response to isolated terrorist attacks that results in the complete breakdown of communications, visits, and trade flows between India and Pakistan (and thus does not discriminate between the few perpetrators of militant acts and the vast majority of the Pakistani population) will have to be avoided. Imposing sanctions on people already hurting from barbaric acts of terrorism is counterproductive in realizing the vision of a prosperous and peaceful Asian economic region.

ENDNOTES

1. This essay draws on Ijaz Nabi and Kiran Javaid, "Regional Trade Panel Report," DPRC Working Paper, Development Policy Research Centre, Lahore, April 2011, a report prepared for the Pakistan Business Council, http://dprc.lums.edu.pk/components/com_publications/attachments/Regional-Trade-Panel-Report.pdf.
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6. Pakistan Ministry of Commerce, *Pakistan-India Trade: Transition to the GATT Regime* (Islamabad: Government of Pakistan, 1996); Ijaz Nabi and Anjum Nasim, "Trading with the enemy: A case for liberalizing Pakistan-India trade," in Sajal Lahiri (ed.), *Regionalism and Globalization: Theory and Practice* (London: Routledge, 2001), 170–197; Zareen F. Naqvi and Ijaz Nabi, "Pakistan-India Trade: the Way Forward," in Michael Kugelman and Robert M. Hathaway (eds), *Hard Sell: Attaining Pakistani Competitiveness in Global Trade* (Washington, DC: Woodrow Wilson Center Asia Program, 2008), 149–171.
7. Garry Pursell, Ashraf Khan, and Saad Gulzar, "Pakistan's Trade Policies: Future Directions," International Growth Centre, report prepared for the Planning Commission of Pakistan, 2011, http://www.theigc.org/sites/default/files/Pursell%20et%20al_Pakistans%20trade%20policies.pdf.
8. This discussion is based on Ijaz Nabi, "Lifting the India-Pakistan Trade Game," *The Hindu*, March 28, 2012, http://www.thehindu.com/opinion/lead/lifting-up-the-indopak-trade-game/article3251761.ece.

Perspectives from India

ARVIND VIRMANI

What is the business view in India regarding the prospects for a broader trade relationship with Pakistan? I will briefly start with that, and then go on to some broader issues from my experiences dealing with the reform of trade tariff policy, with which I have been deeply involved in India. My perspective reflects my 20 years of involvement in issues of trade, tariffs, and tax policy in India. Just as an example, I was a member of the study group on the India-China FTA (which has never been implemented).

My general perception of Indian business on the issue of expanding trade ties with Pakistan is that business is quite sanguine; most members of the Indian business community are very positive about India-Pakistan trade and economic relations. It is useful to understand why. One reason for this optimism is the reform experience in India in the 1990s on both trade and tariffs. To give a sense of what this means to those who have not followed Indian reforms, peak tariffs on manufacturing in the 1990s were 250 percent. By the first decade of the present century, however, they were down to 10 percent. In the 1990s, virtually everything for the general economy (i.e., apart from production for exports) had quantitative restrictions (QRs), which resulted in random levels of import protection. By 2000, this was all gone, at least as far as manufactures were concerned.

So what to make of this? A story I sometimes tell highlights the point. There used to be an item many people today have never heard of—something called "dead-burned magnesia." This was produced in India by one of the big industrialists, who from the very beginning of import reforms in 1991, would come to see me before every budget and plead that tariffs on this item not be reduced any further, because he

Arvind Virmani is executive director at the International Monetary Fund and affiliate professor and distinguished senior fellow at George Mason University.

would have to go out of production. He came every year for five years, and then suddenly stopped coming. So I started wondering whether his business had disappeared. Well, some years later I read in the newspapers that dead-burned magnesia is still being produced in India and the business continues to thrive.

The moral of that story is that it turns out that all those who thought that a reduction in QRs and tariffs would wipe out Indian industry were wrong. People like me who were pushing for liberalization inside the government were right. We expected industry to adapt, adjust, and survive—and it did, contrary to the fears of 99 percent of the elites, academics, and economists and other people in India who thought Indian industry would die. Eventually Indian industry realized that it could not only compete with the best but also thrive. So that is one of the main reasons why Indian industry today is not apprehensive about the prospect of expanding trade with Pakistan.

The second reason for the attitude of Indian industry is that in the states bordering Pakistan—for example, Punjab—there is a kind of historical memory (at least among older people) about the 1950s and early 1960s. Before 1965 and the outbreak of war between India and Pakistan that year, there was normal cross-border trade and economic relations for mutual benefit. There was no border before 1947, and so the issue of local—what one might call local and provincial comparative advantage—was experienced by people on both sides of the current border. Those of us who think of national issues often tend to forget that local economies also exist. There is local interaction, and there are still people in the Indian Punjab at least and hopefully in Pakistani Punjab who remember these earlier interactions. One way to put this more starkly is that even though Punjab is the agricultural heartland of India, the state also is home to small industry, which has been competing with large industry for decades. So again, there is this feeling that yes, there will be adjustments, but if you are not complacent, you can find your comparative advantage.

So that is my perception of why Indian business, by and large, is not apprehensive about trade and greater economic interaction with Pakistan.

The second point I want to touch on briefly relates to the global experience. There is now convincing research from Latin America and other places about the effect of growth poles that shows that a high growth economy has a positive impact on the growth of its neighbors. This of course is not absolute, and it depends critically on interconnectedness, which I will touch upon in a moment.

Let me start by saying a little about growth in Asia, in South Asia, and not just India. I recently completed an update on my study on high growth economies. It turns out that one of the fastest growing economies in the world was Bhutan between 1982 and 1997. There have been only 20 such economies in the world, out of all those for which data is available, and Bhutan was one of them. That growth had to do with hydropower of course. Another fast growing economy, one that may surprise you, happens to be Myanmar, which was also among the fastest growing economies in the world during recent decades.[1] Currently it turns out there are only five (what I call) high growth economies, or potentially high growth economies in the world. One of these five happens to be India. So the point here is not India, or Bhutan, or Myanmar. The point is that growth poles have an effect on neighbors, and that some of the fastest growing economies in the world in recent decades have been in South Asia.

This brings us to interconnectedness. Obviously a necessary condition for neighbors to benefit from fast growth is that they must be connected to the fast growing economies; otherwise they could not benefit from the growth pole, whatever it is. There has been a lot of talk about the soft part of interconnectedness, such as tariffs and QRs, and the essay in this collection by Professor Nabi mentions the hard part, namely infrastructure and highways. You need the connections; without them you cannot have the benefits. Now one of the thoughts that came to me is that perhaps in developing this interconnectedness in terms of infrastructure, we could think of public-private partnerships (PPPs), and business participation, so that the business interest is widened on both sides, Pakistani and Indian. If some of this infrastructure is developed in a PPP mode, a wider segment of business can benefit from the construction activity, not just the government.

My third point is also touched upon to some extent in several of the other chapters in this volume, including those by Professors Nabi and Husain. The point I want to make here is that it is very important for those who have a positive view of Indo-Pakistan economic relations to do research, and to look for and publicize the conclusions that come out of this research, because the negative is always publicized and sensationalized by large segments of the media. We see this all the time in India, and every other country in the world, including the United States. The negatives will always be blown up. So it is very important to find the positive, and to make the positives known. This is not a question of biasing one's conclusions. It is just working to make the facts known to everybody so that people can make informed judgments.

So, for example, the first thing everyone should be aware of is that there is a pure deadweight loss from India-Pakistan trade that is going through third countries. Once this trade takes place directly between the two countries, instead of transiting third states, we should see a visible improvement, because this is going to be a shared benefit. It is absolutely clear that both sides will benefit from it, because there is a huge deadweight loss involved in routing trade through other countries, and we should be looking out for that, and publicizing it.

The second lesson worth emphasizing, besides the growth pool experience, relates to free trade agreements (FTAs). An Indian think tank, ICRIER, which I ran for awhile, undertook a study looking at India-Pakistan trade liberalization while I was there. It was part of a program looking at several such agreements. We also looked carefully at the experience of the Indo-Sri Lanka FTA. The subsequent discussions on these studies as well as Sri Lankan business views gleaned on my visits to Sri Lanka showed a positive view on the value of the FTA with India on the part of Sri Lankan academics and industry.

Let me amplify this a bit by making two points, the first based on what I observed personally, the second that I learned from a Sri Lankan businessman. The first one, which I actually saw, had to do with what I would call the reduction or elimination of trade diversion. For example, I was struck by the number of Indian-made Tata trucks on Sri Lankan roads. In a way, that was not surprising, because Tata had already beaten the best Japanese manufacturers in India in open competition following the reduction in quantitative restrictions and tariffs. And the reason for that was simple—Tata trucks are more suited to Indian road conditions, and the general conditions in which they are maintained. The whole structure of usage in India (and Sri Lanka) is different from what it is in the West. So again, the point here is that one has to be careful. Pakistanis might see a similar change, but they should not see that as a loss for

Pakistan. The losers would really be the Japanese or other exporters. But it is very important to be clear about that.

The second thing that I learned, from the Sri Lankan businessman, was that the FTA allowed him and his business peers to have a certain amount of economies of scale so they could test their products outside Sri Lanka. Consider, for instance, their expansion into South India, particularly Tamil Nadu, with tea. Twenty years ago, you would never have thought of having Sri Lankan tea in India, because we were one of the biggest exporters and producers of tea. Now you do see that. Sri Lankan tea growers have now moved into the neighboring Indian state of Tamil Nadu, and established their brand names. So the economies of scale afforded by an FTA really do offer an opportunity for a smaller country to test its markets, and develop a little bit of skill, which then allows it to go out and compete in a totally different market.

So these are two things, I would submit, that Pakistanis have to be aware of, and see how they can use. In the case of Sri Lanka, they also used the opening to increase tourism from India, and this could also conceivably apply to Pakistan. The point is not that tourism per se is likely to be important in the India-Pakistan context, but that business has to be alert and open to all kinds of new opportunities that might arise, and be ready to grab them. You have to have a positive attitude.

My final point relates to new initiatives. Let me put it in two different ways. In thinking of any next steps beyond MFN, it will be useful to re-energize SAFTA (the South Asian Free Trade Agreement). For a long time SAFTA was handicapped by a fundamental constraint, the asymmetry in MFN status between Pakistan and India, because of Islamabad's refusal to grant MFN to India. Once this asymmetry is removed through effective MFN status for India in Pakistan, the foundation will be set for SAFTA to progress with greater speed and effectiveness. One might anticipate substantial gains from that. And this would also provide political cover to those who are in favor of free trade versus those who are opposed in principle to this concept. SAFTA in a way provides the cover for doing this. As Professor Nabi (among others) argues elsewhere in this volume, fully implementing SAFTA could convert South Asia into a true crossroads.

Looking even farther afield, South Asia is a potential crossroads not only to Central Asia, but also to Southeast Asia. This is a particularly opportune moment, because of the recent opening of Myanmar. So I would suggest that we should research the potential gains from this development and identify how one could move forward in transforming South Asia into a genuine crossroads to both Central and Southeast Asia.

ENDNOTE

1. For this surprising record, see Arvind Virmani, "Accelerating and Sustaining Growth: Economic and Political Lessons," IMF Working Paper WP/12/185, International Monetary Fund, Washington, DC, July 2012.

Managing India-Pakistan Trade Relations

ISHRAT HUSAIN

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

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

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

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Ishrat Husain is dean and director of the Institute of Business Administration in Karachi.

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

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

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

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

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

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

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

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

Source: Economic Survey of India.

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

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

Source: Federal Bureau of Statistics, Government of Pakistan.

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

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

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

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

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

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

VOICES OF PAKISTANI BUSINESSMEN

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

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

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

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

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

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

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

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

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

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

MAJOR RISKS TO TRADE RELATIONS

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

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

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

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

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

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

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

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

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

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

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

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

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

POLICY RECOMMENDATIONS

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

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

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

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

- Both countries should reactivate the South Asian Free Trade Area (SAFTA) and agree on a phasing-out of the sensitive list (of items that each country deems important for its economy) over the next few years. A restrictive list would nullify all the potential gains of preferential trade access.
- Financial and banking services play a catalyst role in promoting international trade. In 2005, Governor Y. Venugopal Reddy of the Reserve Bank of India and the author (then the governor of the State Bank of Pakistan) signed an agreement to open branches of two Indian banks in Pakistan, and two Pakistani banks in India. This agreement has not yet been implemented, as procedural difficulties have been allowed to overwhelm the substance of the agreement. Without banking services, the opening of letters of credit, and cross-border fund transactions, trade cannot flourish.
- One of the major problems impeding larger India-Pakistan trade flows is the poor state of logistics. The World Bank Logistics Performance Index that measures the efficiency of the customs clearance process, quality of trade and transport-related infrastructure, ease of arranging competitively priced shipments, competence and quality of logistics services, ability to track and trace consignments, and frequency with which shipments reach the consignee within the scheduled or expected time, places both countries quite low. Although the new integrated border check at Wagah-Attari would allow 10 times more trucks to cross, other logistics snags have to be dealt with quickly. Special task forces with adequate powers should be formed for at least the first year to solve the problems and facilitate flows of goods and people.
- India, as the largest economy in the region, has to pursue a more vigorous process of dismantling "behind the border barriers" if it

is to realize its potential. The maze of byzantine regulations and rules and the business processes for cross-border exchange have to be simplified and streamlined. For a country that has some of the most progressive entrepreneurs, eminent intellectuals, scientists, and innovators, and globally competitive human resources, it is not comprehensible why it cannot carry out these needed reforms that will help to realize its potential.

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

CONCLUSION

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

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

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

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

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

Source: Department of Commerce, government of India.

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

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

Source: Federal Bureau of Statistics, government of Pakistan.

Additional Trade Challenges: Transport, Transit, and Non-Tariff Barriers

NISHA TANEJA

India-Pakistan trade relations have drawn considerable attention from the world at large, with the two countries now at a point where significant economic gains could serve as a powerful means for conflict resolution. After a hiatus of three years, commerce secretary-level talks were resumed in April 2011. They proceeded at an unprecedented pace, and culminated with the Pakistani federal cabinet's decision to grant Most Favored Nation (MFN) status to India in November 2011.

Such progress is not surprising. In the last few years, several notable trade-facilitating measures have been undertaken despite events such as the Samjhauta Express blasts in March 2007 (The Samjhauta Express train service runs between New Delhi and Lahore) and the Mumbai terror attacks in November 2008. This represents a marked change from the past (for example, after India's Parliament was attacked in December 2001, the country stopped trade via air and land routes until 2004). In 2004, Pakistan increased the list of items permissible to be imported from India—more often termed the "positive list"—to 767 items (the number was 600 in 2000). In 2005, India and Pakistan revised the restrictive Maritime Protocol that had been in operation since 1975 by allowing the lifting of cargo originating from India or Pakistan to other countries by third-country vessels. This amendment also now allows Indian and Pakistani vessels to lift such cargo from a port in either country that is destined for a third country. Another significant measure involved the opening up of the road route through the Attari-Wagah border for limited commodities in 2005, 58 years after its closure during Partition. In

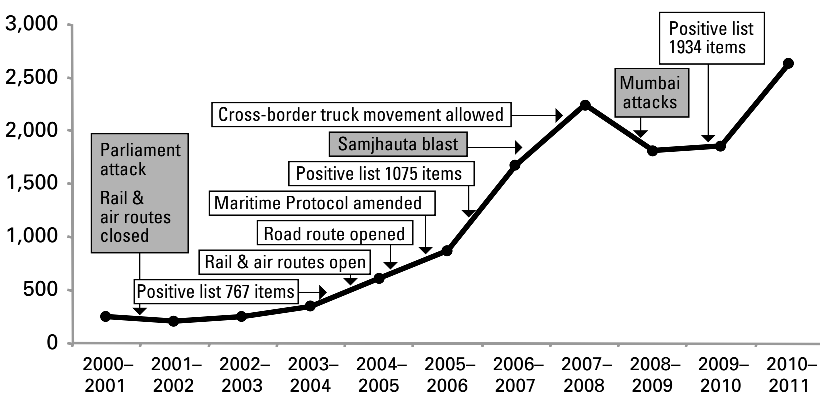
Nisha Taneja is professor at the Indian Council for Research on International Economic Relations.

2006, Pakistan increased the positive list further to 1,075 items. And in yet another historic move, Indian and Pakistani trucks in 2007 were allowed to unload cargo on each other's territory, thereby ending the antiquated practice of porters unloading goods from trucks and carrying them across the border as head-loads. Finally, in 2009, the positive list was increased to 1,934 items (Taneja, Prakash, and Kalita 2011).

An examination of trade trends between India and Pakistan (Figure 1) reveals that in the period between 2004–05 and 2007–08, when a number of positive measures were undertaken, trade more than tripled from $616 million to $2.2 billion (in this paper, all dollar figures refer to U.S. dollars). This occurred even with the politically sensitive events during this period. In 2008–09, following the Mumbai terror attacks and the global recession, bilateral trade fell to $1.8 billion—but then trended upward again, reaching a total of $2.6 billion in 2010–11. The high trade growth in the last couple of years can possibly be attributed not only to the post-recession recovery, but also to the substantial additions to the positive list.

Clearly, the two countries had established a track record of undertaking trade-facilitating measures well before 2011—even in the after-

Figure 1: India-Pakistan Bilateral Trade (US$ Million)



Source: Directorate General of Foreign Trade, Ministry of Commerce, government of India.

math of politically sensitive events. Indeed, the heightened talks initiated in April 2011 leading to the MFN breakthrough were possible because the seeds for change had already been laid in the last few years, therefore making it possible to take bigger and bolder measures.

India and Pakistan are now in the thick of transitioning to normal trade relations. This paper makes an attempt to assess the ground covered so far, the challenges that remain, and the trade opportunities that are likely to open up as the two countries normalize trade ties. On the basis of this analysis, the paper also lays out a roadmap for future measures.

TRADE TRENDS

Bilateral trade between India and Pakistan increased more than 10 times between 2000 and 2010. Total trade between the two countries was $2.5 billion in 2010, of which India's exports to Pakistan were $2.2 billion and imports were $0.3 billion. Despite the positive list maintained by Pakistan, India has always had a trade surplus with Pakistan. India's trade balance as a proportion of its total trade with Pakistan increased from 40 to 80 percent between 2000 and 2010.

India's top 10 exports to Pakistan at the six-digit classification of items accounted for 67 percent of India's total exports to Pakistan in 2010. The top commodities exported from India to Pakistan that year included sugar, cotton, fabric, and organic chemicals. Sugar alone accounted for 24 percent of exports. Dates are the most important item being imported from Pakistan, accounting for 18 percent of total imports in 2010. India's top 10 imports from Pakistan at the six-digit level accounted for 63 percent of its total imports from Pakistan in 2010. Other items in the top 10 imports included cement, woven fabrics of cotton, petroleum oil, organic chemicals, and plastic (see Table 1).

TRADE POSSIBILITIES

The still-restrictive trade regime and the presence of large informal trade flows indicate that there is a huge untapped trade potential between India and Pakistan. There are items that the two countries can import from each

Table 1: India's Top 10 Exports to and Imports from Pakistan ($ Millions)

Product Code	Product Description	Exports	Product Code	Product Description	Imports
170199	Cane/beet sugar & chemically pure	458	080410	Dates, fresh/dried	44
520100	Cotton, not carded/ combed	300	252329	Portland cement (excl. white cement)	28
540710	Woven polyester fabric	232	271019	Petroleum oils & oils	26
170111	Cane sugar, raw, in solid form	142	290315	1,2-Dichloroethane	12
290243	p-Xylene	124	291736	Terephthalic acid & its salts	11
230400	Oil-cake & other solid residues	76	283620	Disodium carbonate	9
071320	Chickpeas (garbanzos), dried, shell	57	780110	Unwrought lead, refined	8
290241	o-Xylene	42	520932	Woven fabrics of cotton	6
540754	Oven printed polyester fabric	29	390120	Polyethylene having a specific gravity of 0.9	6
999999	Commodities not specified	28	390110	Polyethylene having a specific gravity <0.	6
	Total	**1488**		**Total**	**157**
	Share in total exports	**67**		**Share in total imports**	**63**

Source: UNCOMTRADE database, http://comtrade.un.org/.
Note: The products p-Xylene, o-Xylene, 1,2-Dicholoroethane, and Terephthalic acid are organic chemicals. Disodium carbonate is an inorganic chemical. Polyethylene is the most common plastic material, and is largely used for packaging.

other instead of from elsewhere in the world. In order to identify these items and assess the magnitude of trade possibilities (referred to as trade potential) between the two countries, in late 2011 the author calculated an estimate of potential bilateral trade. Products having trade potential were identified as those with (a) adequate demand in the receiving country and (b) adequate supply capabilities in the source country. The exercise was conducted by posing Pakistan as a supplier to assess its possibilities to India, and then by posing India as the supplier country.

The results of the exercise show the existence of an estimated bilateral trade potential of $25.2 billion in 2010, which is 10 times larger than the current $2.5 billion trade (Taneja and Kalita 2011).

India has an untapped export potential of $21.1 billion, of which $7.2 billion can be accounted for by petroleum products alone. Exports of petroleum products by India to Pakistan can increase manifold with Pakistan's granting of MFN status to India. Compared to Bangladesh, Sri Lanka, and Nepal, India's exports to Pakistan in this sector are quite low. In 2010, India's petroleum oil and products exports to Nepal were the highest at $627.8 million, followed by Sri Lanka at $598 million, and Bangladesh at $110.1 million.

The 10 largest items having export potential from India to Pakistan accounted for 45.5 percent of total export potential. Cotton and organic chemicals like para-xylene, which are already major export commodities to Pakistan, are shown to have additional potential for exports of $459.8 million and $230 million, respectively. Other items in the top 10 products having export potential include light petroleum oils & preparations, motor vehicles, telephones, and tea (see Table 2).

Pakistan's export potential to India in 2010 was $4.1 billion, of which $1 billion was petroleum products. The value of the 10 largest items with export potential from Pakistan to India was $2 billion, which accounted for 49 percent of total export potential. Dates have an additional export potential of $52.3 million. The top 10 products having export potential include petroleum oils, cotton, jewelry, and electric generating sets (see Table 2).

It is to be noted that India and Pakistan have an export potential in petroleum oils. However, at a disaggregated level, Pakistan's major petroleum oil export is base oil, while India's comparative advantage within petroleum oil lies in high speed diesel, aviation turbine fuel, fuel oil, and lubricating oil.

TABLE 2: TRADE POTENTIAL ($ MILLIONS)

Product Code	Product Description	India's Exports to the World	Pakistan's Imports from the World	India's Exports to Pakistan	India's Trade Potential
271019	Petroleum oils and oils obtained from bituminous minerals, other than crude	21029.6	6551.9	1.0	6551.0
271011	Light petroleum oils & preparations	15071.7	686.4	25.5	660.9
520100	Cotton, not carded/combed	2973.0	760.2	300.3	459.8
851712	Telephones for cellular networks	1481.9	425.4	0.0	425.4
390210	Polypropylene, in primary forms	800.0	329.1	20.6	308.5
870322	Motor Vehicles	2151.8	285.8	0.0	285.8
090240	Tea, black (fermented)	570.7	298.5	22.5	276.0
290243	p-Xylene	426.4	353.6	123.6	230.0
890520	Drilling platforms for light vessels, dredgers, etc.	1072.9	200.4	0.0	200.4
721049	Flat-rolled products of iron/ non-alloy	662.5	199.5	0.3	199.2

Product Code	Product Description	Pakistan's Exports to the World	India's Imports from the World	Pakistan's Exports to India	Pakistan's Trade Potential
271019	Petroleum oils and oils obtained from bituminous minerals, other than crude	1194.8	2949.1	2.9	1191.8
901890	Instruments and appliances used in medical, surgical, dental, or veterinary sciences	219	334.1	0.3	218.7
711319	Articles of jewelry and parts	576.9	178.1	0.2	177.9
520100	Cotton, not carded/combed	216.7	84.1	0.1	84
730690	Tubes, pipes, and hollow profiles	69.2	76.5	0.1	69.1
220720	Ethyl alcohol & other spirits	86.7	66.6	0.1	66.6
850239	Electric generating sets	66.3	56.8	0.1	56.7
080410	Dates, fresh/dried	52.4	95	0.1	52.3
730890	Structures and parts of towers, tubes, etc.	46.2	149.3	0.1	46.1
252329	Portland cement	373.8	42.5	0	42.4

Source: UNCOMTRADE database, http://comtrade.un.org/.

It is important to acknowledge that such estimates have their limitations. First, all computations are based on only one year's data (2010). While using data for one year allows us to focus on the most recent data, this approach excludes the items that were traded in previous years. Second, these estimates do not take into account differences in the prices of commodities being supplied by the partner country and by suppliers from the rest of the world.

THE EVOLUTION OF INDIA-PAKISTAN TRADE: FROM POSITIVE LISTS TO MFN

In the period following the partition of India and Pakistan until the formation of the World Trade Organization (WTO), the two countries traded in a limited number of items. In 1996, India accorded MFN status to Pakistan. However, Pakistan continued to follow the positive list approach for imports from India. Even with the commencement of the South Asian Free Trade Area (SAFTA) in 2006, Pakistan did not grant MFN status to India. The positive list approach was a clear violation of SAFTA, as it implied discriminatory treatment vis-à-vis other member countries.

Trading under the positive list approach led to massive informal trade flows, mostly in items excluded from the positive list. In 2004–05, informal trade was estimated to be as large as formal trade (Taneja 2005), indicating the vast potential that exists between the two countries. Almost 88 percent of informal trade is routed through third countries (mostly Dubai). Here, goods enter into the Pakistani market after passing through Iran and Afghanistan, or directly to Karachi by sea.

Even though an expansion of the positive list from 875 items in 2000 to 1,934 items in 2009 led to increased trade, the expansion was concentrated in three sectors: chemicals, base metals, and machinery and electronics—accounting for 59 percent of the total number of items on the positive list in 2009. Also, the expansion was not based on any economic criteria. In several sectors there was no expansion in the positive list, as protectionist lobbies with vested interests did not allow additional market access to Indian products. These included sectors like footwear and other accessories, ceramic and glass products, and gems and jewelry (Table 3).

Administering the positive list created several unnecessary hassles for traders in both countries. The classification codes provided by Pakistan for the positive list did not match with the Indian classifications. Due to the mismatch in classification, customs officials very often classified items under the positive list at their own discretion. Additionally, in some cases the descriptions of items provided in the positive list did not match with the Indian classifications, and for some of these a corresponding description did not even exist. Frequent changes in the positive list created uncertainty for traders. Permitting imports of certain items from India for only limited periods further created ambiguities in the trading environment (Taneja 2007). The positive list approach lacked transparency, created uncertainties for traders, and led to high transaction costs.

Perhaps a major problem associated with the positive list is that a separate list has been maintained for the road route between the two countries at the Wagah border crossing. Along this trade route, only 14 of the 1,934 items on the overall positive list are allowed to be traded.

In accordance with the sequencing and timelines for the move toward full normalization of trade laid down by the two countries in the joint statement of November 2011, Pakistan made a transition from the positive list approach to a small negative list of 1,209 banned items. In the next stage (and as of this writing), the negative list was to be phased out by the end of 2012. Until the negative list is abandoned completely, the positive list will continue to be in operation, though in a much more reduced form.

THE CHALLENGES OF TRANSPORT AND TRANSIT

The movement of goods between and through the two countries has long been undercut by inadequate logistical support required for trade. The road route was closed for several years; rail and air links have been cut off several times; and the sea trade has operated under a very restrictive agreement. These impediments have led to high transaction costs of trading. Since 2005, several measures have been undertaken to improve infrastructure and to remove restrictions on the movement of goods by road, rail, sea and air. These policies are likely to bring about a reduction in the costs of trading. However, for further reductions in these costs, several new steps need to be taken to achieve the goal of seamless transportation

Table 3: Distribution of Pakistan's Positive List

Section	Section Description	Positive List (2000)		Positive List (2009)	
		Number of Items	% of Total	Number of Items	% of Total
I	Live animals	10	1	31	2
II	Vegetable products	68	8	156	8
III	Animal/vegetable fats/oils	20	2	22	1
IV	Prepared foodstuffs	5	1	11	1
V	Mineral products	37	4	74	4
VI	Chemical/allied industries	260	30	568	29
VII	Plastics and rubber articles	30	3	91	5
VIII	Raw hides and skins, leather, fur skins	9	1	45	2
IX	Wood products	61	7	52	3
X	Paper products	23	3	37	2
XI	Textile products	34	4	103	5
XII	Footwear, headgear, etc.	1	0	2	0
XIII	Articles of stone, plaster, cement, etc.	5	1	27	1
XIV	Precious or semi-precious stones, precious metals, imitation jewelry	2	0	5	0

Section	Section Description	Positive List (2000)		Positive List (2009)	
		Number of Items	% of Total	Number of Items	% of Total
XV	Base metals and their articles	169	19	227	12
XVI	Machinery and mechanical appliances; electronics and electrical equipment	83	9	352	18
XVII	Vehicles and transport equipment	15	2	20	1
XVIII	Optical, photographic, cinematographic products, and parts	37	4	102	5
XIX	Arms and ammunition		0	0	0
XX	Miscellaneous manufactured articles	5	1	5	0
XXI	Works of art	1	0	2	0
XXII	Miscellaneous goods		0	2	0
	Total	**875***	**100**	**1934**	**100**

Source: Federal Board of Revenue, government of Pakistan (various notifications).

**The original notification has 600 items with sub-items. When the latter were counted separately, the total amounted to 875 items.*

between India and Pakistan. This section of the paper discusses the measures taken so far and the impediments that must still be addressed.

Road Transport

The opening of the Attari–Wagah road route in 2005 was a historic move. It was followed by yet another trade-facilitating measure in 2007: Trucks from the two countries were permitted to unload goods on each other's territory. This does not happen in the case of India's road trade links with Nepal and Bangladesh, which have been operational since Partition. In theory, transport protocol on the India–Nepal border permits trucks from the two countries to move on each other's territory. However, in practice, goods from trucks from one country are offloaded and loaded on to the other country's truck at the border. This is because weak border institutions have inhibited the effective implementation of policies. On the other hand, the rigid land border between India and Pakistan, which was closed to trade for several decades, has enabled change to occur. Indeed, the institutional framework supporting trade between the two countries is strong enough to counter lobbyists and interest groups that may have been in opposition. This raises immense hopes for successful implementation of further trade-facilitating measures.

Unfortunately, however, road transport has not been developed to its full potential. Only 14 items are permitted to be traded via road. The Attari/Wagah route continues to be the only operational option for India–Pakistan trade, even though India has notified 16 land routes for trading between India and Pakistan.

A major concern until recently has been the poor infrastructure at land borders such as warehousing, parking, scanners, weighbridges, testing laboratories, and other border facilities. A single gate available for exports, imports, pedestrians, and passengers has caused major congestion at the border. Congestion is also caused by excessive checking of trucks due to security issues at India's sensitive land borders, especially at the Pakistani side of the border. The need to set aside time for the famous Wagah border ceremony for tourists has added to the pressure on trading across the border.

A major problem that has restricted the through-movement of goods is the requirement of transhipment of goods at borders, mainly due to the absence of road transport agreements that would permit the seamless movement of trucks. This not only adds to time and cost, but also leads to higher incidences of damages and pilferage. There are also restrictions on the sizes of trucks, which prevents containerized trucks from carrying cargo across the border for unloading. This has posed a major limitation to the cost-efficient movement of goods across borders.

Fortunately, a number of measures have been instituted in recent years to address the above problems. The Indian government initiated the setting up of 13 Integrated Check Posts (ICPs) at identified entry points on its international land borders. The ICPs at Attari/Wagah became operational in April 2012. ICPs provide a dedicated passenger and cargo terminal with adequate customs and immigration counters, X-ray scanners, passenger amenities, and other related facilities (like service and fuel stations) in a single modern complex equipped with state-of-the-art resources including facilities for electronic data interchange.

In line with the joint statement submitted by the two countries in November 2011, India's completion of ICPs was to be accompanied by Pakistan abandoning a positive list and moving to a negative list for road-based trade. However, as of May 2012, no announcement had been made by Pakistan to do so. Another pending task for the two governments is to amend road trade protocol to allow through-movement of containerized trucks across the two borders.

Rail Transport

The rail route has been the dominant surface-transport mode for India-Pakistan trade. However, even this mode has been limited in its reach. In both countries, goods move by train only over a small distance of 30 kilometers between Amritsar and Lahore. For the remaining connections between origin and destination, goods are transhipped onto trucks and then moved. Thus, typically, a consignment originating in Delhi would be moved by road to Amritsar and then transhipped to rail for onward movement to Lahore through the border at Attari. This adds considerably to the time and cost of transporting goods.

With the setting up of the ICP at Attari/Wagah, infrastructure has improved considerably, but several barriers remain. A single rail route through the Attari/Wagah border, infrastructure that remains inadequate, and the poor quality of rolling stock are some of the problems that traders have faced for a long time, and continue to face now. A scarcity of wagons, and difficulties in allotting them, have encouraged agents to seek huge rents from traders in exchange for the allotment of wagons. Such a non-transparent trading environment restricts the free flow of information, and creates uncertainty for traders. It has also been found that traders in Kolkata, located in eastern India, find it difficult to trade through the Attari/Wagah land border, because information on how to trade by the rail route is not accessible to them. Therefore, these consignments are sent by sea to Colombo and then to Karachi (Taneja 2007). Another major problem is that current agreements permit only certain types of wagons to move between India and Pakistan. This limits the transportation of containerized wagons, and consequently the movement of those commodities that require containerization. As a result, containerized cargo destined for Pakistan moves via a circuitous route through the port in Mumbai, instead of through the much shorter direct route through Attari/Wagah.

The agenda for improving rail transport should include the implementation of mechanisms that allow for the containerization of rail cargo, an improvement in rolling stock and wagon availability, and greater automation that will improve transparency and reduce information asymmetries related to trade.

Sea Transport

Until recently, India and Pakistan followed a very restrictive maritime protocol. The protocol allowed only Indian and Pakistani vessels to carry cargo between the two countries, and did not permit Indian and Pakistani vessels to send cargo destined to a third country from the ports of either country (in essence, India could not send cargo to a third country from Pakistan, and vice versa). This arrangement restricted competition from foreign vessels, and therefore resulted in high sea freight rates being charged by Indian and Pakistani vessels for cargo being shipped between the two countries. However, there was no restriction on the movement of transhipped cargo. Hence, several trading firms in India and Pakistan transhipped their goods through Colombo. However, the protocol was amended in 2005, and as a result sea trade between the two countries now takes place under global maritime arrangements and practices, whereby countries are free to send cargo via foreign vessels, and can also send cargo to a third country through the port of another country. This amendment has led to greater competition, and therefore to a reduction in costs for sea-based trade between Mumbai and Karachi.

Transit Issues

The ongoing bilateral dialogue between India and Pakistan has so far not addressed the issue of transit. India has not allowed Pakistan to access Nepal, Bangladesh, and Bhutan through its territory. Similarly, Pakistan has not given any transit rights to India to access the Afghanistan market for its exports. However, Pakistan offered transit rights to Afghanistan's exports through its territory to reach the Indian market in 1948.

Until recently, Afghan transit goods in Pakistan were transferred under the Afghan Transit Trade Agreement (ATTA) signed by the two countries in 1965. In July 2010, Afghanistan and Pakistan signed an amended transit trade agreement, the Afghanistan-Pakistan Transit-Trade Agreement (APTTA), which improves the joint transit system to reflect current economic conditions, infrastructure, technology, and transport practices. The new transit regime provides for an increased number of transport routes available to trucks from Afghanistan and Pakistan, lowering the cost of imports and making exports more competitive in the global market. However, the APTTA does not allow India's exports to Afghanistan through Pakistan via the land route.

In order to increase their gains from the trade normalization process, India and Pakistan must put this transit issue on their trade agenda.

Transaction Costs

It follows from the above analysis that prior to the amendment of the maritime protocol and the opening of the road route in 2005, the restrictive trade and transport regimes created a high-cost trading environment for India and Pakistan. Based on a survey in January 2005, Taneja (2006) provided estimates of transaction costs on alternative routes and compared these routes in terms of efficiency parameters. These estimates were based on responses provided by freight forwarders and traders on the costs they incurred prior to the opening of the road route and liberalization of the sea route.

The key land route Delhi-Amritsar-Attari (road-cum-rail) was compared with the more indirect Delhi-Mumbai-Karachi route (land-cum-sea). The latter was used because the Delhi-Attari route was not always accessible due to various impediments associated with rail transportation. Additionally, the most important sea route connecting Mumbai and Karachi was compared with the more indirect Mumbai-Dubai-Karachi route. The latter route has for several years been used to transport items not on the positive list.

The transaction cost elements for which data was obtained included the cost of transportation and other transaction costs (such as bribes to various authorities, notably those with customs and railways). Based on the data collected, a comparison was undertaken of total transaction costs—in terms of absolute costs, and in terms of efficiency measured by costs incurred per container per kilometer.

The survey results indicated that absolute transaction costs per container on the indirect route were much higher than those accrued on the direct routes. Thus, on the Mumbai-Dubai-Karachi route, transaction costs were 1.3 to 1.7 times greater than those between Mumbai and Karachi. The discrepancy was found to be even more glaring with the Delhi-Mumbai-Karachi route. Here, transaction costs were 2.7 times greater than those on the direct route between Delhi and Attari (see Table 4).

In terms of efficiency (transaction costs incurred per container per kilometer between direct and indirect routes), the study found that the indirect Delhi-Mumbai-Karachi route is 1.9 times more efficient than the direct Delhi-Attari road-cum-rail route, and that the indirect Mumbai-Dubai-Karachi route is 2.6 times more efficient than the direct Mumbai-Karachi route.

A useful insight from the above analysis is that to overcome barriers posed by the trade and transport regimes, traders developed alternative routes where liberal markets in trade and transport allowed for greater efficiency. There is not much incentive, then, for traders to use the direct inefficient routes for trade between India and Pakistan. This also explains the persistence of trade through indirect routes for almost six decades. The switch to direct routes can happen only if there are substantial improvements in efficiency. Since 2005, a number of trade-

Table 4: Route-Wise Comparison of Transaction Cost (TC)

	Distance (Km)	Total TC Cost $ per Container	Transaction Cost $/ Container/ Km
Land			
Delhi-Attari (road-cum-rail)	479	415	0.87
Delhi-Mumbai-Karachi (rail-cum-sea)	2274	1058	0.47
Sea			
Mumbai-Karachi	885	576	0.65
Mumbai-Dubai-Karachi	3127	776–976	0.25–0.31

Source: Taneja (2006).
Note: Estimates for transport and other transaction costs were obtained for a 20-foot sea container. Load costs for land transport were obtained for the same quantity.

facilitating measures have been taken and the situation on the ground may well have changed. Nonetheless, the above study provides a useful benchmark against which fresh estimates can be prepared and compared.

NON-TARIFF BARRIERS

Pakistan has been extremely concerned about non-tariff barriers that it faces in accessing the Indian market. Pakistan has identified several non-tariff measures (under the sub-group on non-tariff barriers set up under SAFTA) which it deems trade restrictive. In fact, the imposition of Non-Tariff Measures (NTMs) is legitimately allowed under various provisions of the World Trade Organization (WTO) to ensure safety and to protect plant, animal, and human life provided they meet the principle of MFN treatment and the principle of national treatment. The latter principle prohibits discrimination between domestic and foreign goods in the application of these measures. The provisions under the WTO's Agreement on Technical Barriers to Trade (TBT) permit members to apply measures largely to manufactured products provided they are not trade restrictive.

Similarly, members are allowed to apply Sanitary and Phytosanitary (SPS) Measures only to the extent necessary, and based on sufficient scientific evidence. These measures, when applied in a trade-restrictive manner, obstruct trade and pose non-tariff barriers. Thus, complex procedures and a lack of transparency in regulations are some examples of measures that could be trade-restrictive.

An analysis of the non-tariff measures notified by Pakistan under SAFTA shows that some of them did not pose any barrier because they were compliant with WTO rules, or because corrective action had already been undertaken (Taneja, Rastogi, and Rai 2008). Other measures were found to be trade-restrictive on account of non-recognition of standards, lack of transparency of rules and regulations, lack of infrastructure, and complex and cumbersome procedures.

The measures perceived as being discriminatory were related to various levies and taxes imposed by India on the interstate movement of goods. Although these measures restrict trade by inflicting additional transaction costs, they do not qualify as non-tariff barriers. This is because similar treatment is accorded to interstate movement of domestic goods. Necessary corrective action is being taken as part of the ongoing reform process in India.

There were other notified NTMs where India had already initiated corrective action, but SAFTA member countries (such as Pakistan) are unaware about many of these actions. For instance, Pakistan notified that a labeling requirement under the Jute and Jute Textiles Control Order of 2000, which stipulated that each and every imported jute bag must give the "Country of Origin" on the bag, discouraged imports as bags carrying such labeling could not be used for packing goods made in India. The marking requirement was amended in 2002, directing every jute bag to be marked/printed/branded "Bag made in—Country of Origin." However, despite this amendment, Pakistan had notified that the Control Order of 2000 was a barrier for Pakistani exporters. A similar problem was found in a measure related to clauses in the Indian Customs Act pertaining to valuation not consistent with GATT Article VII (which lays down the general principles for an international system of valuation). The required amendments in the Customs Act were made in 2007, yet this NTM was notified under the SAFTA subgroup on NTMs. This indicates a lack of awareness about the amended Indian Customs Act.

The NTMs found to be trade-restrictive included some TBT and SPS measures. This is because their implementation involved cumbersome procedures, either because of the involvement of multiple agencies or due to too many formalities that raise the costs of trading considerably in terms of both time and money. Some TBT- and SPS-related barriers emerge from inadequate testing facilities at ports that sometimes lead to delays and additional costs, because samples have to be sent to distant locations for testing. In other cases, Indian authorities did not accept pre-shipment test certificates (including with leather and textile products) from the exporting country, which again have led to delays and additional costs.

In the case of exporting agricultural products to India, Pakistan notified that the process of required Pest Risk Analysis (PRA) was complex and non-transparent. This is unfortunate, given that a detailed examination of the process of PRA has revealed that the process of obtaining a PRA is clearly laid out in the Plant Quarantine Order of 2003, and is available on the Ministry of Agriculture website. The author's discussions with authorities in the Plant Quarantine Department in India reveal that Pakistani exporters have made a request for PRA to be conducted on very few items—suggesting that Pakistan shies away from making requests because it is too intimidated by the process, despite the availability of clear information about the process.

In the case of pre-packaged products such as processed foods, cosmetics, toiletries, and spices, Rule 32 of the Prevention for Food Adulteration Act (PFA) pertaining to labeling requirements is complex and detailed. Similarly, the import permit required for poultry, dairy products, and meat was reported by traders to be very time-consuming.

Trade also gets restricted due to regulations that lack transparency. Regulations related to wool and other textiles and jute products have not been notified to the WTO. This creates information asymmetries for trading partners. In the case of wool textiles, the regulation also lacks clarity on the requirement of a "brand owner" certificate. Such regulations can be applied arbitrarily, as they are open to interpretation.

Only one measure, related to labeling requirements for processed foods, qualified as a barrier on account of its violation of the principle of national treatment. The measure requires processed food items to have a shelf life of at least 60 percent of its original shelf life at the time of import. There is no such stipulation for domestic goods, for which only the date of expiry needs to be mentioned on processed food items. Interestingly, Pakistan has a similar requirement for imports of processed food items—the only difference being that the requirement of shelf life is 50 percent at the time of import.

The above analysis suggests that India should review and simplify procedures for all products, especially for those requiring urgent attention—such as food and agricultural products, processed foods, and pharmaceutical products. To improve transparency, India should notify all measures to the WTO. In order to address the issue of non-acceptance of testing and certification, India should enter into Equivalence Agreements and Mutual Recognition Agreements with Pakistan. The former creates a framework for recognition of different but equivalent measures to achieve international standards. With the latter, countries agree to mutually accept the results of one another's conformity assessment procedures. And most importantly, infrastructure constraints should be addressed so that they do not restrict trade.

Non-tariff barriers were a central issue in the commerce secretary-level talks. To address non-tariff barriers, a Joint Working Group was set up. Recognizing that there was a lack of awareness about the regulatory regimes on both sides, India and Pakistan adopted a unique and simple method to create awareness amongst Pakistani government officials and businesspersons about their regulatory regimes. The two countries arranged business-to-business and government-to-business interactions to address information gaps on the regulatory regimes (Taneja 2011).

In addition to the above barriers, there are other barriers that Indian and Pakistani traders have faced in accessing each other's markets. It has been pointed out that on grounds of security, excessive checks are carried out on consignments imported from Pakistan (Taneja 2007). Fortunately, the new infrastructure set up at the Attari/Wagah border crossing provides for adequate scanning equipment so that traders are not unduly harassed.

VISAS

One major pending issue is related to visa restrictions. Granting city-specific visas; the requirement of police reporting on arrival and before departure; the requirement of exit from the port of entry; and delays in granting visas are some of the restrictions that have limited market access for aspiring traders (Taneja 2011).

Consulates in both countries have exercised tremendous discretionary powers in granting visas and waiving visa requirements. Consulates have allowed some traders to be exempted from scrutiny by the Ministry of Home Affairs in India and Ministry of Interior in Pakistan. They have also extended the length of stay; exempted traders from police reporting; and removed restrictions on the number of cities to be visited. Selected traders who are beneficiaries of such largesse make repeated visits and have access to trade-related information. On the other hand, lack of transparency, market imperfections, and information asymmetries raise transaction costs and restrict market access for several other aspiring traders. Indian officials argue that, for the sake of security, rigorous screening of visas is essential. While it is true that no compromise can be made on national security issues, it needs to be recognized that genuine traders often become victims of a strict visa regime.

In October 2011, India and Pakistan finalized the draft text of an agreement for streamlining visa procedures between the two countries, and was submitted to the respective governments. Nearly a year later, in September 2012, the two capitals concluded an agreement that loosens visa requirements in both countries. There is no doubt that a more liberal visa regime can provide an effective channel for information exchange on trade-related matters between the two countries.

RECOMMENDATIONS

The trade normalization process is expected to unleash huge trade opportunities for India and Pakistan. However, for this trade to be realized, several measures need to be undertaken by both countries. Two concrete steps that have been taken since the commerce secretary-level talks are the phasing in of MFN and the setting up of modern infrastructure facilities at the Attari/Wagah border on the Indian side. If infrastructure is not upgraded on the Pakistani side, the full benefits of improved infrastructure cannot be reaped. Doing away with the positive list on the road route will bring about a quantum jump in trade at considerably lower costs. Other measures that need to be taken to increase trade on the road route include removing restrictions on truck type, and permitting Indian and Pakistani trucks to move freely on each other's territory so that there is no need for transhipment at the border. Similarly, permitting containerized rail cargo will facilitate trade immensely. These changes should be supplemented with the two countries granting transit rights to each other.

Finally, India and Pakistan are trying to address the non-tariff barriers faced by Pakistani businesses in entering the Indian market. Some of the measures that can be taken include improving infrastructure for testing facilities, simplifying procedures, and entering into equivalence agreements and mutual recognition agreements. However, very often non-tariff barriers are perceived to exist where they actually do not, due to a lack of information about each other's regulatory regimes. Creating multilevel channels of communication can reduce misconceptions, bridge the information gap, and generate a significant change in the business environment of the two countries. These channels can be effective only if the visa regime is also liberalized.

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What Can India and Pakistan Do To Maximize the Benefits from Trade?

KALPANA KOCHHAR AND EJAZ GHANI

India and Pakistan, South Asia's two largest countries (they have a total population of 1.4 billion people), share a common border, culture, and history. Yet despite their proximity, the two countries barely trade with each other. India's trade with Pakistan accounted for less than half a percentage point of India's total trade in 2010, and Pakistan's trade with India was less than 5 percent of its total trade.

This is about to change. In 2011, Pakistan decided to grant Most Favored Nation (MFN) status to India, reciprocating India's granting of MFN status to Pakistan in 1996. India now plans to liberalize visa and investment regimes to boost trade and business-to-business contacts. By extending MFN status to India, Pakistan will replace a positive list with a negative list of goods and services to be traded with India (that is, it will switch from a list of goods and services that can be traded to a shorter list of goods that cannot be traded). As of this writing, the negative lists of both countries were to be eliminated by December 2012. After the transition to MFN is completed, the plan is that sensitive lists will be further liberalized.[1] Both India and Pakistan will gradually phase out all tariffs on traded goods, with an expectation of zero tariffs by 2016, as required by a fully implemented South Asian Free Trade Area (SAFTA).

What will be the gains from trade for India and Pakistan? Which industries are likely to benefit? How important is it for the liberalization of trade policy to be accompanied by other reforms to improve infrastructure, connectivity, and logistics? Our ongoing research shows that for

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Kalpana Kochhar is chief economist for the South Asia Region (SAR) of the World Bank. **Ejaz Ghani** is an economic adviser for SAR.

trade liberalization via the granting of MFN status to generate the greatest gains for India and Pakistan, it is critical that there are accompanying reforms of trade facilitation and connectivity. Trade facilitation reforms will lead to the reduction of behind-the-border barriers, and decrease the cost of trading across borders. These reforms could include improvements in infrastructure, institutions, services, procedures, and regulatory systems. The results of general equilibrium simulations (described in detail later on) suggest that Pakistan's granting of MFN status to India will generate larger trade benefits only if it is supported by improved trade facilitation and connectivity. In other words, the net economic impact of improved trade facilitation would be larger for both Pakistan and India, and eventually would lead to stronger economic growth for the region.

What is remarkable about South Asia is that it is the second fastest growing region in the world, but it is also the least integrated region. The region has integrated with the world, but not with its neighbors. This low level of integration has implications for prosperity and the pace of poverty reduction in South Asia. Two of the poorest South Asian countries, Afghanistan and Nepal, are land-locked. Several lagging regions of the larger South Asian countries of Bangladesh, India, and Pakistan are located in border areas. Out of the 14 states in India that have borders with neighboring countries, 12 have per capita income levels at or below the national average (Arunachal Pradesh, Assam, Meghalaya, Mizoram, Nagaland, Tripura, Manipur, West Bengal, Bihar, Uttar Pradesh, Jammu and Kashmir, and Rajasthan). In Pakistan, per capita income is lower than average in the border provinces of Khyber Pakhtunkhwa, Baluchistan, and rural Sindh. In Bangladesh, the border districts tend to have per capita incomes lower than the national average. Typically, these sub-regions have poor connectivity with markets in neighboring countries. This in part explains why the poverty mass in South Asia is concentrated in the lagging regions, many in the border regions, while economic mass is concentrated in the leading regions.

South Asia's coming demographic transition, and the fact that traditional advanced country partners may have entered a prolonged slowdown, provide new momentum for local and regional integration. Improved peace and stability, the demographic transition, and better trade facilitation will make domestic markets even larger. Increased regional trade could be the catalyst that attracts global production centers to

South Asia, as firms move in response to wage differences. Additionally, the recent headwinds from the Euro crisis have caused a deceleration in exports and a reversal of portfolio capital, and lowered gross domestic product (GDP) growth in developing countries. Some of these downside risks to growth can be minimized through increased South-South trade, such as that in South Asia.

CURRENT STATE OF BILATERAL TRADE BETWEEN INDIA AND PAKISTAN

India and Pakistan have one of the world's most restrictive trade regimes. Barriers to trade are complex, and particularly "thick" at the land border. These barriers can be divided into three different categories:

- Tariff barriers.
- Non-tariff barriers—a bigger constraint to trade than tariff barriers.
- Trade logistics and connectivity—the biggest constraints to trade in South Asia.

All of these add to high transaction costs and longer times for trading. High costs of trading have restricted the growth benefits of scale economies, specialization, and agglomeration economies. These costs have diverted employment and trade from formal to informal sectors. Estimates on informal trade between India and Pakistan vary from half a billion to about a billion dollars (all dollar figures in this essay refer to U.S. dollars). A large proportion of informal trade occurs via Dubai, a process which is inefficient and costly. Informal sectors account for the majority of non-agricultural jobs in the region (Ghani and Kanbur 2012).

So what do India and Pakistan trade? Indian exports to Pakistan are largely limited to about 15 commodities (De, Raihan, and Ghani 2012). These goods accounted for around 64 percent of the total Indian exports to Pakistan in 2000, rising to around 80 percent by 2010. These commodities include sugar, raw cotton, synthetic fabrics, tea, and petroleum products and chemicals, reflecting India's diversified industrial base. Shares of both raw cotton and woven fabrics in India's exports to Pakistan increased from almost negligible amounts in the year 2000 to more than 13 percent in 2010, whereas the share of oil-cake and other solid residues contracted from about 16 percent to 3 percent during the same period.

The composition of official exports from Pakistan to India has been limited to just a few commodities: fruits and vegetables, wool and related products, petroleum products, chemicals, lead, and, more recently, cement. The sectors with large shares of exports from Pakistan to India in 2010 were fruits (19 percent), followed by cement (11 percent), and petroleum products (7 percent).

What about informal trade? The main Indian products that reach Pakistan informally include tires, auto components, pharmaceuticals, engineering products, chemicals, and some textiles. These sectors in India are therefore expected to benefit from a better trade environment. Pakistani consumers will benefit from reduced prices for these products. Meanwhile, Pakistan's unofficial or informal exports to India include cement, fruit and vegetables, cotton, some specialized textiles, and sports items—currently arriving via Dubai. These are all expected to experience a rapid boost with more formal India-Pakistan trade.

THE COST OF TRADING

Trade and good infrastructure are fundamental building blocks of economic development. Trade logistics encompass an array of essential activities for trade—transit trade, warehousing, cargo consolidation, border clearance, distribution, and payment systems. Poor logistics deter engagement in regional production-sharing. Countries with better logistics can grow faster, become more competitive, and increase their investment. Better logistics can have a greater effect on trade promotion than can tariff cuts; boosting logistics performance in low-income countries to the middle-income average could enlarge trade by around 15 percent, according to some estimates. This would benefit firms and people, because they would receive lower prices. It would also support diversification into higher value-added exports, new goods, and modern services. Reducing the cost of trading can substantially increase trade in goods, services, ideas, capital, and the movement of people—and thereby increase regional growth by one to two percentage points (Ahmed, Kelegama, and Ghani 2010).

Improving trade logistics is not enough. Transport and connectivity also need to be improved. India and Pakistan cannot trade much due to poor and restricted transport. India and Pakistan have a 3,323-kilometer land border that demarcates the Indian states of Punjab, Rajasthan, and Gujarat from the Pakistani provinces of Punjab and Sindh. However,

Table 1: Trade/Transport Links Between India and Pakistan Are Weak

Sector	Route
Road transportation (passenger bus services)	Delhi-Lahore
	Amritsar-Nankana Sahib
	Amritsar-Lahore
	Poonch-Rawalkot
	Srinagar-Muzaffarabad
Rail transportation (passenger train services)	Delhi-Lahore
	Jodhpur-Karachi
Shipping links	Mumbai-Karachi
Air links	Delhi-Lahore
	Mumbai-Karachi
Gas pipeline	TAPI*
Electricity links	Amritsar-Lahore*
Border (land) customs for trade	Wagah-Attari
	Poonch-Rawalkot
	Srinagar-Muzaffarabad
	Munabao-Khokhrapar*

Note: *=*Proposed /to be operational*

this immense frontier has few trade transportation links (see Table 1). In addition to the Attari-Wagah border, which is the major road and rail crossing between India and Pakistan, three more land routes (Muzaffarabad-Srinagar, Poonch-Rawalkot, and the not-yet-operational Khokrapar-Munabao) have been used for trade between the two countries. India and Pakistan have only one direct sea route (Mumbai-Karachi) and two air routes (Delhi-Lahore and Mumbai-Karachi).

Restrictions imposed by the two countries on trade along the border have led to the opening of many indirect (and informal) trade routes, some of which act as major trade axis. Mumbai-Dubai-Karachi and Mumbai-Dubai-Bandar Abbas-Afghanistan-Pakistan are the prominent ones.

Regional transport is not well developed for most countries in South Asia. Road network quality is low, with few regional linkages, while rail networks between ports and markets are often missing, thereby putting unnecessary burdens on already-inadequate road networks. Only a limited number of items are allowed to be transported via rail/road, there are specific timings for the opening of these routes, and in most cases there are no proper warehousing/storage facilities available. Information flows on trade-related matters are particularly weak, thereby generating enormous problems for exporters and importers. Since banks are not allowed to open branches across the border, this leads to significant delays, especially when letters of credit need to be confirmed, which can take up to a month. There are no institutions or regional mechanisms for addressing trade disputes or grievances.

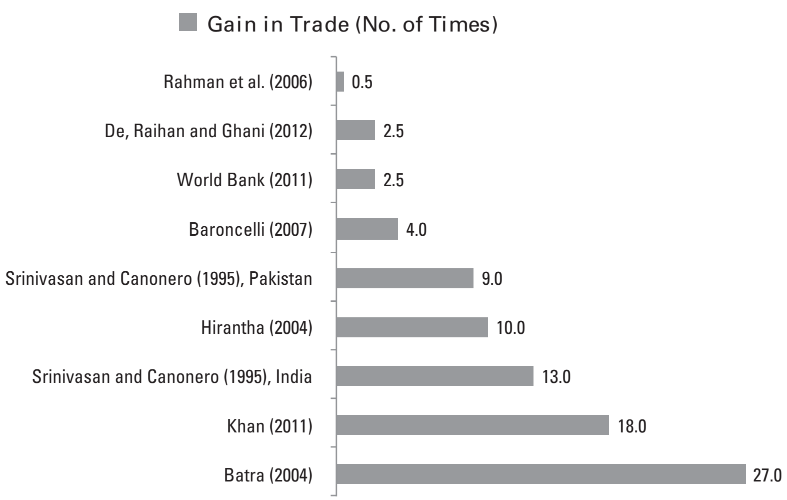
It is therefore not surprising that the cost of trading in South Asia is among the highest in the world—even higher than in Africa. Indeed, several South Asian countries are ranked lower than Sub-Saharan Africa on the Logistics Performance Index by the World Bank.[2] For example, crossings between India and Bangladesh are so heavily congested that queues often exceed 1,000 trucks on the Indian side, with the result that crossing times can take 99 hours (compared to 21 hours in the absence of delays). Two hundred signatures are needed before Nepal can trade goods with India.

India and Pakistan do not extend freedom of transit to each other or to international traffic in transit. Transit of Pakistani goods through India to Bangladesh and Nepal is prohibited. Pakistan places restrictions on transit trade from India to Afghanistan. Additionally, testing laboratories for trade between India and Pakistan in agriculture, processed food, chemicals, and garments are not available at borders. Given all these limitations, the returns from investments to improve trade facilitation and transport can be huge in South Asia, even with modest resources and limited capacity.

GAINS FROM TRADE BETWEEN INDIA AND PAKISTAN

Several empirical studies have examined the likely gains to be made from removing the barriers to trade between India and Pakistan (see Figure 1). Some estimates suggest that with a bilateral free trade agreement, trade potential is nearly 20 times larger than it is today. For example, according to a Peterson Institute for International Economics gravity model estimate, total trade between India and Pakistan could expand from its current level of $2.5 billion to as much as $42 billion for the two countries (Khan 2011). Other estimates assert that gains could increase by as much as 27-fold.

Figure 1: Gains in India-Pakistan Trade, Gravity Estimates



Source: De, Raihan, and Ghani 2012.
Note: Base year varies across gravity estimates.

Most argue that trade potential between the two countries would be much higher than the current level if the large volume of informal and/or third-country trade were to be counted. The bottom line is that deeper engagement through normal bilateral trade would lead to significant welfare gains between the two countries.

Our ongoing research has examined several scenarios on the gains from trade using a global computable general equilibrium (CGE) model and country dynamic CGE models (see De, Raihan, and Ghani 2012 for a detailed study). The CGE modelling framework of the Global Trade Analysis Project (GTAP) (Hertel 1997) is a useful tool for examining the economic and trade consequences of multilateral or bilateral trade agreements. The GTAP model is a comparative static model, and uses a common global database for the CGE analysis. The model assumes perfect competition in all markets, constant returns to scale in all production and trade activities, and profit- and utility-maximizing behavior of firms and households, respectively.[3] Our research used UNCOMTRADE trade data (De, Raihan, and Ghani 2012 and Hertel 1997). While the alternative scenarios provide important insights, our research is still at an early stage, and much more analysis is needed.

TWO TRADE OPTIONS

Two options that examine the benefits of trade policy liberalization and improvements in trade logistics are discussed below.

Option 1: Pakistan gives MFN to India (with or without improvement in trade facilitation)

In this first option, empirical simulations were based on two scenarios. In the first scenario, Pakistan gives MFN status to India without trade facilitation. Here, it is assumed that Pakistan extends MFN treatment to India by replacing its positive list with a negative list. The second scenario involves Pakistan extending MFN status to India and, in addition, there are improvements in trade facilitation between the two countries. In the second simulation, it is assumed that the transportation cost for bilateral trade in goods between India and Pakistan will decrease by 25 percent. The CGE simulation suggests significant gains for both Pakistan and India under these scenarios. Not surprisingly, the gains are higher with improvements in trade facilitation.

The simulations indicate that the welfare effects of MFN would be very high for India and Pakistan if trade policy liberalization is accompanied by improved trade facilitation measures, and in particular reduced transport costs. Therefore, improvement of connectivity and trade facilitation between India and Pakistan should get the utmost priority in order to make the benefits arising from new trading arrangements more inclusive. The global CGE simulation suggests that there would be some trade diversion after Pakistan grants MFN status to India, as Pakistan would divert some of its imports from other countries to India. But the simulations suggest that this trade diversion would result in negligible welfare effects on the other countries.

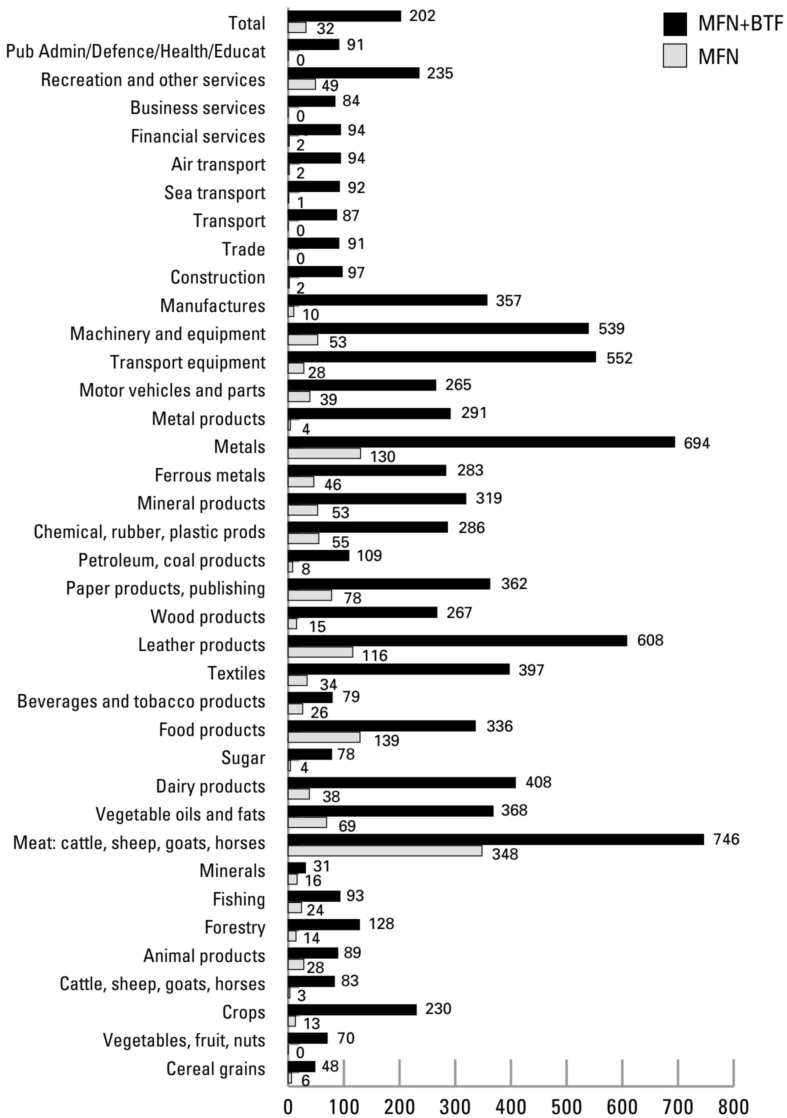
Figure 2 shows a list of sectors that would benefit from a rise in imports from India. These benefits would arise due to India's unit-cost advantage compared to that of Pakistan's other trading partners. The change in imports by Pakistan from India would vary from dairy products to vegetables, fruits, and nuts. Pakistan's imports from India would rise in chemicals, rubber and plastic, food processing, mineral fuels (petroleum and coal products), metals, machinery and equipment, textiles, leather products, and sugar, for example.

However, under the MFN-plus-trade facilitation scenario, there would be much larger rises in imports from India. Pakistan's exports to India, meanwhile, would rise by a staggering 202 percent under the MFN-plus-trade-facilitation scenario, against only 0.19 percent under the mere MFN scenario.

Option 2: SAFTA (with or without MFN given to India and trade facilitation between India and Pakistan)

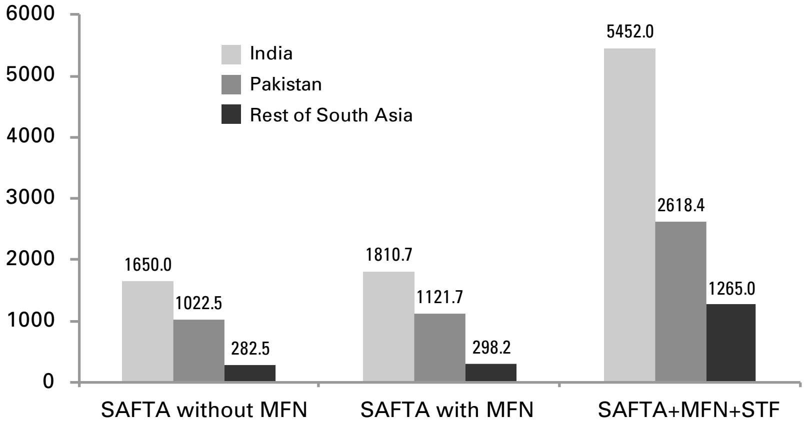
Full implementation of SAFTA refers to a situation where the customs duties of all traded goods are reduced to zero by the year 2016. Three scenarios are simulated here. First, the full implementation of SAFTA; second, full implementation of SAFTA with the granting of MFN by Pakistan to India; and third, full implementation of SAFTA, MFN, and trade facilitation improvements. The results suggest that the

Figure 2: Sectors Getting Higher Market Access in Pakistan (Percent Change in Imports of Pakistan from India)



Source: De, Raihan, and Ghani 2012.
Note: BTF=Better trade facilitation.

Figure 3: Welfare Scenario of SAFTA (in Millions of Dollars at 2007 Prices)



Source: De, Raihan, and Ghani 2012.
Note: STF = Trade facilitation among SAFTA member states.

SAFTA-with-MFN scenario would lead to somewhat higher welfare gains for Pakistan and India than a scenario of SAFTA without MFN. And as in the previous simulation, when the bilateral trade facilitation scenario is added, the gains from trade are much higher.

The results suggest that the SAFTA-with-MFN scenario would lead to higher welfare gains for Pakistan and India than a scenario of SAFTA-without-MFN. However, when a South Asian trade facilitation scenario is added, such gains become much larger. The SAFTA scenario (with or without MFN) would however lead to some welfare losses for Bangladesh, because of larger trade diversion effects than trade creation effects (Raihan 2012).

POLICY RECOMMENDATIONS

The results of the general equilibrium simulation indicate Pakistan's granting of MFN to India would generate larger benefits if supported by improved connectivity and trade facilitation. The net economic impacts of SAFTA along with trade facilitation are beneficial to both Pakistan and India, and eventually would lead to stronger economic growth for the region on the whole. Moving forward, policymakers need to give more emphasis to two *Is*—integration and investment.

Recommendation 1: Integration

Trade policy remains a key instrument for greater market integration. Although average trade tariff rates have come down in both India and Pakistan, tariff dispersion remains high. High tariff rates still persist on some major products. In addition to rationalizing import duties, policymakers should eliminate regulatory duties and other para-tariffs, along with several other restrictive measures that have limited trade in the past.

Despite the fall in average tariffs, the trade restrictiveness of both India and Pakistan has been heavily triggered by the large volume of non-tariff barriers (NTBs). In promoting trade between India and Pakistan, the major stumbling block is the presence of such NTBs; a list of such NTBs is provided below (more details are available from De, Raihan, and Ghani 2012).

- *Subsidies*: India provides abundant subsidies to agricultural producers and consumers; Pakistan provides excessive subsidies for wheat, cotton, fertilizers, and power.
- *Trade procedures*: Some Indian banks do not recognize letters of credit from Pakistani banks, and vice versa.
- *Visa regimes*: Very restrictive on both sides, with only one port of entry and exit. The visa regime on India's side is unpredictable, city-specific, single-entry, and limited to a few days.
- *Air travel*: Very limited; only a few flights.

- *Road and rail travel*: Limited traffic, and rail wagons carrying goods are required to return empty.
- *Sea travel*: Ships are required to touch a third country port (e.g. Dubai or Singapore) before delivering import goods, except limited ports of call between Karachi and Nava Sheva (in Gujarat).
- *Services/IT*: Heavy restrictions limit professional exchanges/cooperation.
- *Services/Banking*: Bank branches are not allowed, and exports/imports need to be made through a third country.
- *Standards:* The Bureau of Indian Standards requires a certificate for cement, whereas it takes six months (though only three weeks in theory) to clear certification. Pakistani laboratory reports produced to demonstrate compliance with certification requirements for fabrics and garments are often not accepted in India. Finished leather from Pakistan requires an additional certification from the Indian veterinary department.
- *Infrastructure*: Whereas Pakistan can unload/load 30–40 trucks at a time at Wagah, India can only manage two trucks. A 10-hour window is given to Indian importers to unload/load, clear customs, and reload, but this is hardly ever accomplished on time. Warehousing facilities on both sides of the border are inadequate. Behind-the-border facilities are very poor. For example, a major part of the road linking Wagah with Panipat on India's National Highway 1 is narrow.
- *Trade logistics*: Goods move by air, sea, and rail between India and Pakistan. Road routes for trade are limited, and rail and air connections between the two countries have been erratic. Interchanges between Pakistani and Indian railways take place only on Sundays. There are restrictions on modes of transport for export goods. For example, cement exports to India are allowed only by train, but exporting large quantities via train is not possible as the frequency of trains running between India and Pakistan is very low. There is significant port congestion, high port costs and demurrage (charges for holding and storing

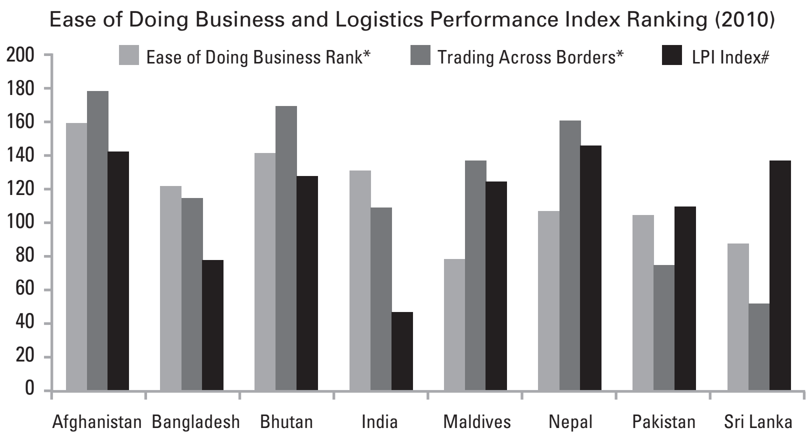
currency), cumbersome paper work, and generally more issues of trade and transport facilitation in Pakistan.

Table 2 presents a list of impediments to India-Pakistan trade. Deeper cooperation between India and Pakistan can potentially result in significant reductions of these barriers.

Trade in the region is constrained by poor infrastructure, congestion, high costs, and lengthy delays. These problems are particularly severe at India-Pakistan border crossings.

The World Bank Logistics Performance Index (LPI) is based on a worldwide survey of operators on the ground (global freight forwarders and express carriers), providing feedback on the logistics "friendliness" of the countries in which they operate and those with which they trade. They combine in-depth knowledge of the countries in which they operate with informed qualitative assessments of other countries with which they trade, as well as the experience of the global logistics environment. Infrastructure stands out as the chief driver of LPI progress. The quality

Figure 4: Poor Logistics Deter Engagement in Regional and Global Production Sharing



Source: World Bank, Doing Business 2012 *and World Bank, Logistics Performance Index (LPI).*

**=184 countries, #=155 countries.*

Table 2: Impediments to India-Pakistan Trade

Tariff barriers	Customs duties
	Special additional duties
	Countervailing duties
Non-tariff barriers	Stringent visa regimes
	Trade-distorting subsidies
	Overland transportation limitation
	Air travel restrictions
	Sea transportation restrictions
	Transit restrictions
	Port of call restrictions
Finance measures	Cumbersome payment systems
	Restrictive official foreign exchange allocations*
	Regulations concerning terms of trade for import payments**
	Non-acceptance of letters of credit
	High commission of foreign banks offering letters of credit
	Lack of bank branches
Quality control measures	License with no specific ex-ante criteria***
	License for selected importers
	Sanitary and phytosanitary measures
Technical barriers to trade	Marking requirements
	Labeling requirements
	Testing, inspection, and quarantine requirements
	Pre-shipment inspection/certificate acquisition

Sources: Taneja 2012 and Khan 2011.

**Indian firms and individuals are subject to capital account restrictions.*
***If imports of physical capital exceed $15,000, an international bank must cover the advance remittance through a bank guarantee.*
****A special import license is required to import certain goods.*

and availability of trade-related infrastructure, especially roads, still constrains logistics performance. The quality of logistics services—trucking, forwarding, and customs brokerage— is also central to trade efficiency. Logistics performance is strongly associated with the reliability of supply chains and the predictability of service delivery.

The picture on the ease of doing business and trading across borders, particularly for intra-regional trade, is not impressive for most South Asian countries. Among the major causes of high trade transaction costs are numerous cumbersome and complex cross-border trading practices, which also increase the possibility of corruption. Goods carried by road are subject to transshipment and manual checking at the border, which impose serious impediments to trade. This is further compounded by a lack of harmonization of technical standards.

The CGE simulations show that improved trade facilitation could increase the volume of trade between India and Pakistan by reducing the transaction costs of trade, and thereby making exports more competitive and imports less expensive.

To support trade flows between the two countries, India's Integrated Check Post at Attari-Wagah border, inaugurated on April 13, 2012, is a welcome step forward. With regard to physical infrastructure, the Wagah border-control facilities must be greatly expanded. Specifically, sophisticated X-ray machines through which trucks can pass quickly should be a top priority; warehousing is needed at Attari; and several new train stations need to be built.

Recommendation 2: Investment

Globalization has created immense opportunities for countries to catch up and grow. It allows countries to benefit from scale and specialization, and from the knowledge and technologies that have been developed anywhere in the world, whether embodied in machinery, intermediates, or inflows of foreign direct investment (FDI). World trade has experienced a boom in the last decade, driven by technological changes that have lowered the costs of communication and transport. The resulting globalization of production, with its associated value supply chains, has lowered prices and increased the variety of imported goods and services for firms and consumers. It has also led to unprecedented inter-linkages and inter-dependency among countries.

At present, despite being a fast growth region, South Asia barely attracts any FDI inflows. But MFN status, peace and stability in the region, the rise of the middle class, favorable demographic trends, and improved governance should begin to attract FDI inflows.

Increased FDI inflows will help firms in India and Pakistan exploit economies of scale through access to an enlarged market, and through increased specialization from better access to technology. In view of the bigger market size, MFN status to India would attract Indian FDI to Pakistan, thereby facilitating greater specialization and intra-industry trade between the two countries.

For example, the export of petroleum products from India to Pakistan is one aspect of trade relations that will benefit from the new arrangement. Lakshmi Mittal, an Indian steel tycoon, is currently constructing a new oil refinery in the border city of Bhatinda in India's Punjab state, in association with India's Hindustan Petroleum Corporation. The facility will eventually have the capacity to supply large amounts of petroleum products to northern Pakistan. Undoubtedly, more FDI flows would precipitate a huge expansion in the number of new opportunities, such as Mittal's initiative, for trade and commercial enterprise in the region.

India clearly has a desire for more bilateral investment with its western neighbor. Recently, based on an estimate provided by Pak-India Business Council Chairman Noor Muhammad Kasuri, Indian investors have shown a willingness to invest \$20 to \$50 billion in Pakistani mining, petroleum, energy, power, and infrastructure projects. The Indian private sector has also shown an eagerness to export electricity to Pakistan through the Wagah-Attari border. Additionally, once trade ties with Pakistan are strengthened, opportunities for transformational regional projects like the gas pipeline between Turkmenistan, Afghanistan, Pakistan, and India are likely to become a reality as well.

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ENDNOTES

1. A sensitive list is a list of goods established by each country for which no tariff concessions are made available.
2. The Logistics Performance Index is based on a worldwide survey of operators on the ground (global freight forwarders and express carriers). They provide feedback on the logistics "friendliness" of the countries in which they operate and in those with which they trade.
3. Full documentation of the GTAP model and the database can be found in Hertel 1997 and also in Dimaranan and McDougall 2002.

Non-Trade-Related Stakes of the Pakistan-India Relationship

AMIN HASHWANI

This essay, while acknowledging the immense importance of trade between India and Pakistan, focuses on the non-trade-related stakes of this relationship. People in both countries draw stimulus from the maturity of civil society, the old game of perceptions, the recent phenomena of the media *raj*, and most importantly the security dynamics of our region. The essay examines each of these issues in detail. It also describes how expanded bilateral trade can strengthen a relationship that already shows great signs of warming—especially on people-to-people levels—and can increase prospects for peace in India and Pakistan, and across South Asia on the whole.

BACKDROP

The independence of the Subcontinent from British rule and the simultaneous creation of India and Pakistan have produced one of the most turbulent and violent divisions of the post-World War era. These events represented much more than a process of forced separation or the creation of a distinct political entity. Rather, they formed the basis for long-term practices such as identity, work, and memory, and they had far-reaching sociological implications for communal patterns, generational dynamics, and individual lives. First-hand memories of the migrations, casualties, and myriad dispossessions of homes and property that affected millions of people are still vivid for the older generation, posing

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Amin Hashwani is a businessman and founder of the Pakistan-India CEOs Business Forum.

a challenge for their children and grandchildren to move forward and create a more positive relationship between the two countries. The three wars of the last six decades; unresolved and lingering political issues, such as Kashmir, Sir Creek, and Siachen; and trade and travel restrictions that are still stubbornly in place have not helped the situation. In addition, new issues such as water, terrorism, and the war in Afghanistan that have cropped up in the last decade have all added to the list of challenges for normalizing the relationship between the two countries.

CIVIL SOCIETY: DEFYING CONVENTIONS

With this backdrop, it would be reasonable to assume that the chances of achieving a viable peace between the two countries in the near future would be highly unlikely. In many conflict zones around the world—such as the Middle East, the Balkans, Africa, and the Caucuses—persisting animosities between governments have invariably trickled down to ordinary citizens. However, strangely enough in the case of Pakistan and India, despite their historic scars and current challenges, the positive chemistry that exists on a people-to-people level is unmatched and unprecedented in a way that defies convention. Whether we are speaking of personal visits in each other's countries, periods of study at universities, business delegation exchanges, or simply a cab ride on the streets of Karachi or Mumbai, the warmth displayed for the other is exceptional, unprecedented, and defies anything one might expect. Indeed, because of this, in both countries it is civil society that has been the strongest proponent of peace, and whenever a window of opportunity has arisen to bring the two countries closer, it is this demographic that has invariably risen to the occasion—sometimes playing a pivotal role in driving the process forward, putting pressure on politicians, and influencing public opinion.

Hawks exist on both sides and occasionally try to derail the negotiation process, but the disproportionately large peace constituencies that exist among both populations are simply extraordinary. Hence one could argue that there has been a failure of the political leadership in both countries to convert this groundswell of goodwill at the individual and societal levels into tangible benefits for the two peoples. Therefore, despite the many challenges on multiple fronts that exist on both sides, there is ample reason for hope that civil society with time will play an important role in the eventual resolution of all major outstanding issues. Despite the slow pace of negotiations, the warmth and positive attitude displayed by both sides during official meetings is extremely heartening. It is perhaps sometimes wiser to proceed slowly and in a measured way with concrete baby steps, in order to ensure that the progress made is irreversible, while steering clear of any potential potholes that can jeopardize this delicate process.

THE PERCEPTION CHALLENGE: CAPTURING THE MINDS OF A VULNERABLE DEMOGRAPHY

Even in the current "information age," misperceptions between nations represent a global phenomenon. The Subcontinent is no exception.

In the last two decades, India, due to economic reforms in the early 1990s, has shifted from embracing a slow "Hindu" growth model to becoming a robust economic powerhouse, on course to play a major international role in the coming years. With a large base of a billion-plus population, it has attracted disproportionate attention internationally among companies and countries as the place to do business. Internationally, it has also begun to gain cultural and political influence. Through "Shining India" and "Incredible India" campaigns and a host of other initiatives, it has attempted to showcase itself as a historical empire whose moment has once again arrived. This is in sharp contrast to Pakistan's development history. Until the 1960s, the nation served as an economic role model for progress that other Asian countries tried to emulate, but now grapples with a host of socioeconomic and geopolitical problems stemming from a series of unfortunate (internal and external) events that it is hard-pressed to cope with.

Perceptions of Pakistan in India

India is a large populous nation experiencing unprecedented growth, and is in the process of redefining itself. Exceptional media attention is given within India to its home-grown Bollywood stars, business titans, and sports icons, not to mention political wrangling, corruption scandals, and local events. This insular mindset leaves limited room for international news to seep in, and perhaps a lack of public appetite for it as well. Pakistan usually registers very low on the media's radar, unless there is a negative event (such as a terrorist attack), an accident, or political turmoil. Positive and constructive news seldom trickles in. Thus India's view of Pakistan as a nation and as a society, seen through this colored lens, is diminutional and frequently quite negative. Travel restrictions, regulated trade, and limited cultural exchanges do not help the situation. In addition, only two journalists are allowed to be stationed in each country—an expanse of 1.4 billion people. No Pakistani television channels are aired in India, and rarely does a Pakistani movie make a dent in the high-budget Bollywood industry.

Perceptions of India in Pakistan

India's dominant media and entertainment industry does a masterful job projecting the country's image globally, including in Pakistan. Indian movies are widely watched in Pakistani cinemas. India's news, entertainment, and sports channels are aired throughout Pakistan's cable networks; its Bollywood stars and products are branded across Pakistani society; and its economic success stories are highlighted in Pakistan's media. This provides an opportunity for the Pakistani public to view India from many lenses. Hence whenever there is negative news emanating from India, people in Pakistan are better equipped to place it in the correct context than are their counterparts across the border when faced with bad news from Pakistan.

It is perhaps normal to expect a degree of misperception to exist between both sides, but in this instance it is weighed disproportionately against Pakistan—especially when Pakistan is seen as an entity that "parted ways" with India at the time of its birth. In the past, Indian politicians have had to resign or were thrown out of their parties for writing or publicly commenting positively about Pakistan or its founding father—not because they were articulating inaccurate information, but because it clashed with the prevailing narrative that Pakistan parted ways on ideological grounds and did not want to be part of a broader pluralistic society. Interestingly, this contrasts with the complimentary views frequently expressed in India about the people of Pakistan as individuals, who are generally seen as warm, hospitable, and seeking better relations with India. This excellent chemistry is quite visible on any occasion when the people of the two countries meet.

With the opening up of trade, one can expect a gradual improvement in the relationship between the two countries. It will increase the level of interaction between business communities, offer cheaper goods and raw materials to consumers and industries, and create many other unforeseen and unintended interdependencies. Easing the visa regime to increase people-to-people interactions and allowing more media personnel to be stationed in each country would create a more positive bias. (A new visa agreement concluded in September 2012 offers hope.) Tourism still remains a significant untapped industry that can catalyze dramatic economic and social dividends.

Already, books by Pakistani authors are available in Indian book stores (this was not the case earlier). Pakistani pop groups, which have a large following in India, are being allowed to perform in India more frequently. And, slowly but surely, regular exchanges between lawmakers, businessmen, and professionals are changing the dynamics of this relationship. The Aman Ki Asha is a peace initiative between the biggest media group in each of the two countries, the *Times of India* and the Jang Group. It has brought together stakeholders in arts, culture, business, and civil society to explore avenues of cooperation and to undertake initiatives for peaceful coexistence. It focuses on areas where the two governments have failed, either due to lack of will or capacity, to deliver on promises for a peaceful region. The movement has been widely supported by the public in both countries, and also acknowledged by the international community as one of the most significant movements for peace launched in the two countries to this point. In the two-plus years since its launch, it has had a dramatic effect in changing public discourse, linking various stakeholders, and dispelling misperceptions that have lingered for decades. Eventually, if joint ventures and investments are allowed into each country, they could plant the seeds of peace and sprout lobbies that create and sustain mutual interests in the long run, and cushion any negative impacts that may arise from future challenges or unfortunate incidents.

In conclusion, while there are misperceptions about Pakistan as a nation and society, the spontaneous positive chemistry at person-to-person levels is quite extraordinary. This weighs heavily in the peace-building process, despite the perceived roadblocks in rapprochement. This in itself is ample reason for optimism for the future. Existing misperceptions can be expected to reduce considerably once trade and other links gradually open up. Positive changes can perhaps happen sooner than anticipated if politicians on both sides demonstrate the proper leadership to push this process further. Social media growing exponentially in both countries can potentially become the game-changer, if nurtured wisely. The advantage of having a common culture, language, history, and border—an advantage that seems to be untapped at the moment—cannot be overstated. Linking the local regions on both sides of the border—like Punjab, where there was historical and natural pre-partition trade—can further boost this process. Pakistan needs to work on countering misrepresentative and negative images not only in India, but in the rest of the world—and especially in the post-9/11 era. The Indian media too must avoid the temptation to sensationalize news from Pakistan in a knee-jerk fashion, and it must provide some space for positive news to filter through.

THE MEDIA *RAJ*

There has been a sudden unleashing of the media in India and Pakistan, both in terms of scale and content. Media companies in the last two decades have gradually gained considerable influence socially, economically, and politically in their respective countries. Their role in the India-Pakistan relationship has been no exception. Two examples demonstrate this point.

In 2001, the Agra Summit brought the two sides together. However, the summit abruptly concluded without a joint statement. Some blame this on a meeting President Pervez Musharraf held during the summit with senior Indian journalists, which was broadcast on live television. It highlighted the different positions of India and Pakistan, and particularly regarding Kashmir. In essence, the Indian media both exploited and weakened the government's position before the Indian public. In such an environment, it was difficult for the Indian government to win the public's approval for an agreement.

In 2004, Musharraf made a proposal on Kashmir that sparked controversy in both the Indian and Pakistani media. He suggested that Pakistan not demand a plebiscite on the status of Kashmir, and that India not demand making the Line of Control an international border. Instead, he suggested that Kashmir be broken down into seven regions, and demilitarized through a phased process. Thereafter, Kashmiris would decide their own fate. The Indian Foreign Ministry spokesman criticized Musharraf for not having first discussed his proposal through diplomatic channels. The Indian media highlighted the reaction of prominent statesman Jaswant Singh, who condemned the proposal as "map-making...in disguise" that needed to cease. The Pakistani media accused Musharraf of selling out on Kashmir. Several days later, Pakistan's Foreign Ministry clarified that Musharraf's proposal was merely meant to generate debate on the issue.[1]

THE SECURITY PREDICAMENT: PAKISTAN'S ARMY AS A DOUBLE-EDGED SWORD

As compared to India, the role of the Pakistan army, which has ruled the country for almost half its history, has historically been more prominent. Although Pakistan has now transitioned into a political democracy, the army still has a strong influence—especially in the areas of defense and foreign policy. The fact that Pakistan, since its inception, has been in a constant state of instability—internally and externally—has not helped matters. Three wars with India, the partition of Bangladesh, support for U.S. interests in the region during the Cold War, a status of front-line state after the Soviet Union's invasion of Afghanistan (and the consequent hosting of over 3 million refugees for over three decades), a key partner in the "war on terror" after 9/11 and the civil wars with the Tehrik-e-Taliban that resulted, the Baluchistan Liberation Movement—all of this has extracted a heavy social, political, and economic price from the Pakistani people. And it has kept Pakistan in a perpetual state of flux, thereby preventing the evolution and development of any state institutions apart from the military itself.

Among other unresolved issues with India, the Kashmir dispute stirs strong feelings. In Pakistan, it is viewed as a people's issue rather than simply a land dispute. From the very beginning, this dispute has strategically poised the Pakistani army against a much larger rival. The fact that India is seven times larger economically and demographically, and boasts a growing defense armory, has increased the sense of insecurity within the Pakistani establishment.

A common perception that has grown over the years is that perhaps the Pakistani army wants to keep the dispute with India festering, so that it can continue to maintain its dominant position within the country. This view is not only widely believed in India and in think-tanks around the world, but also in some circles within Pakistan as well. Against this backdrop, it would be interesting to examine an alternative view.

The Musharraf Era

During President Musharraf's period of rule, there were genuine moves made toward peace with India, with substantial progress made to some extent. This was despite the fact that Musharraf was widely attributed to be the author of the Kargil conflict. Additionally, a few years into his presidency, each country mobilized a million troops "eyeball to eyeball" on the border (the quoted term comes from the *Economist*) following an attack on the Indian parliament.

Musharraf co-initiated the Composite Dialogue process with his Indian counterparts, Prime Minister Atal Bihari Vajpayee and subsequently Prime Minister Manmohan Singh, in an attempt to discuss and resolve all outstanding issues, conditionally but unilaterally moving away from the UN Kashmir resolutions of 1948 and 1949 calling for a plebiscite under UN auspices (which no political or military government had ever done before). He also agreed to a broad framework for a solution on the Kashmir dispute with his Indian counterparts, and ordered a crackdown on militant activities on Pakistan's soil. Musharraf clearly demonstrated a genuine, personal desire to find an equitable and lasting solution to all outstanding issues with Pakistan's eastern neighbor.

It is important to note that these peace initiatives were undertaken by President Musharraf as much in his capacity as chief of army staff as president. These critical decisions could not have been procedurally taken without the consent of the top army brass. If the establishment had deliberately decided to keep the conflict with India brewing for strategic reasons, then none of the progress achieved during Musharraf's regime would have been possible. Even today, neither the government nor civil society has made any undue objection to moving the peace process forward, and nor have they tried to obstruct it—a fact acknowledged by all stakeholders in Pakistan. However, this does not mean that there is no concern within the army about the threats from across the border, or that the sense of insecurity driven by fears of a much larger foe has in any way diminished.

Ground Realities

India's defense budget, which traditionally used to be about double the size of Pakistan's, has in recent decades grown from 20 to 30 percent annually. Today, it stands at about seven times larger than that of Pakistan. This gap continues to grow, since Pakistan's defense budget has remained more or less static due to its internal economic problems.

A commonly cited explanation for India's steep rise in military spending has been that it is acting as a counterweight to China's own military buildup. But the ground realities are viewed very differently in Pakistan. "India's Army and Aerospace Force combat strength is almost totally deployed against Pakistan," writes Ikram Sehgal, a Pakistani security analyst, "but if you were to hear Indian defense analysts (all for western consumption), their main worry is China and not Pakistan."[2]

One can, perhaps, argue about the exact numbers, but the point remains that India's major armed forces are disproportionally positioned against Pakistan. Its future arms build-up is also perceived to be more suitable for the desert terrain of the border with Pakistan than the mountainous border with China. With such a disproportionate arms imbalance and with continued unresolved tensions, there is always the possibility of coercive diplomacy being applied during a crisis. Then there is India's Cold Start doctrine (designed specifically against Pakistan), which many in the Pakistani security establishment perceive as a policy to use limited but offensive and punitive strikes at relatively short notice.[3] Such ground realities continue to seed a "trust deficit" and a sense of insecurity in the establishment, despite the latter's subtle support for the peace process.

TRADE WINDS: WHY NOW?

While there is considerable momentum today for deepening Pakistan-India—and broader South Asian—trade, it was not always this way.

Past Stagnation

India and Pakistan are both members of the South Asian Association for Regional Cooperation (SAARC) organization. And they are both signatories to an agreement to form a concessionary trade regime, the South Asian Free Trade Area (SAFTA). However, SAFTA has failed to be implemented due to lingering political issues. Until recently, India had bypassed the South Asia region and had focused its efforts internationally by signing a series of bilateral trade agreements with countries and regional blocs around the world. In South Asia, despite entering into bilateral trade agreements with all of its regional neighbors (except Pakistan) through arrangements outside the SAARC framework, India failed to open up its internal markets by maintaining high non-tariff barriers. As a result, no meaningful intra-regional trade took place, giving way to a deep sense of frustration in the region about India, particularly given that very few efforts were made to address the region's grievances. Trade surpluses were invariably in favor of India, even though theoretically smaller nations should have benefited more. For a regional bloc to succeed, the largest economy has to play a generous role in the implementation of agreements that favor the smaller nations, both in letter and spirit.

In Pakistan, there was traditionally a fear that if too much progress was made in trade, other unresolved political issues, especially the Kashmir dispute, might be put on the back burner. Therefore the prevailing policy was to move on all issues in tandem, so that progress would be on a sounder footing and issues would complement, rather than compete with, each other.

Change for the Better

All this has changed now. Both India and Pakistan are currently engaged in vibrant trade negotiations, with clearly defined goals and timeframes, and with the ultimate objective of entering into a concessionary trade regime—under the SAFTA agreement, and with all the countries of the region. Since 2011, India has initiated efforts to engage with all its neighbors, not only redressing their trade grievances but also making substantial investment commitments through the large Indian corporate sector. This change of attitude by both India and Pakistan is due to a growing realization that the world is changing, and that they need to adapt to these shifting ground realities.

The Mumbai terrorist attacks led to a severe emotive backlash against Pakistan and especially the Pakistani establishment. However, as India moved from a reactive to a reflective mode, the importance of having a vibrant and stable region for long-term progress became clear. In Pakistan, the fear of undermining its political position by making disproportionate progress on trade with India has died down. This is primarily because the rules and benchmarks of engagement between nations have changed, as economic and political interests have now become intertwined in foreign policies around the world. In the long run, nations now recognize, progress on one front can actually help to resolve issues on other fronts.

China, which is one of Pakistan's closest allies and perhaps a role model for economic development, has focused primarily on trade with its neighbors despite unresolved political issues. China/Taiwan and China/India are the two prime examples where trade and investments have exponentially grown in the last decade, even while political stances have remained intact. If anything, with this increase in economic activities, a vested interest for peace has been created; public discourse has changed; and rhetoric has given way to informed discussion and changing perceptions.

RECOMMENDATIONS

Currently, there is optimism that reasonable progress on trade can be expected by 2013 if both sides implement the road map to which they have committed themselves. However, it is essential that other issues that were part of the earlier Composite Dialogue—including Jammu and Kashmir, Siachen, Sir Creek, Wullar Barrage, terrorism, and drug trafficking—be discussed and negotiated bilaterally between the two countries, and that progress be publicized so that stakeholders are encouraged to support the broader peace process. Similarly, issues that crop up once again or gain importance with time, such as Afghanistan, the environment, water, education, health, and poverty, should also be added or updated to the list of issues on the table. Negotiations must continue on the basis of equity and equality, and blame games or rhetorical terms (such as "failed state," a word generally used against Pakistan when it has faced a challenging situation) must be avoided. The engaged role of civil society should continue, and the Aman Ki Asha initiative should be a role model.

Regional trade blocs generally succeed when the larger economy plays a pivotal part in integration. India must assume this leading role, and embrace the onus of addressing the grievances and insecurities of its neighbors by taking more generous actions. The business communities on both sides are generally supportive of opening up markets and of increasing trade and investments, but such measures should be undertaken in a well-thought-out way so that there are no undue or disproportionate harmful effects to local industries. India, due to its large industrial base, scales of production, indigenous availability of raw materials, and, in recent years, its acquisition of international companies, brands, and technology, enjoys an advantage over its neighbors. Relevant safety measures as allowed under the World Trade Organization must be in place, and closely monitored to avoid any unscrupulous trade practices.

The business community should continue to play an important role in increasing the interactive and commercial activities that come with the liberalization of trade rules, but with managed expectations, as there is generally a time lag for trade to actually materialize on the ground. Traditional trade zones such as the Punjab areas of both nations—which were active and integrated pre-Partition—need to be revived and their natural synergies harnessed. Also, all stakeholders should be vigilant to the unanticipated opportunities that arise once trade between countries opens up after long gaps.

In the coming years, once the true benefits of trade and investment are felt on every level of society—and especially at the common person level, where the availability of cheaper goods from across the border can help mitigate the burdens of poverty and inflation—one can be sure of broad support for lasting and prosperous peace in the region. *Insha Allah.*

ENDNOTES

1. These two examples and the discussion surrounding them are drawn from Farah Zahra, "Sustaining the India-Pakistan Dialogue," *Daily Times*, July 29, 2011, http://www.dailytimes.com.pk/default.asp?page=2011%5C07%5C29%5Cstory_29-7-2011_pg3_2.
2. Akram Sehgal, "India's Possible War Deployment," Sick Semper Tyrannis site, January 14, 2009, http://turcopolier.typepad.com/sic_semper_tyrannis/2009/01/indias-possible-war-deployment-ikram-seghal.html.
3. See Muhammad Azam Khan, "India's Cold Start is Too Hot," *Proceedings Magazine*, U.S. Naval Institute, March 2011, http://www.usni.org/magazines/proceedings/2011-03/indias-cold-start-too-hot.

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Ph: 202-691-4020 Fax: 202-691-4058
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