CHAPTER – IV

ECONOMIC RELATIONS

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Economic Relations

The economy of India is the third largest in the world as measured by purchasing power parity (PPP). When measured in USD exchange rate terms, it is the twelfth largest in the world, with a GDP of US $719.8 billion in 2005. India is the second fastest growing major economy in the world. It is now becoming on the stage to join the club of worlds superpower's due to its 7 to 8 percent as an average growth rate in this century. The reforms of 1990s enabled India to sustain a relatively high pace of economic growth, though they did not accelerate it durably. Before the reforms, the Indian trade and Investment regimes were characterized by pervasive quantitative restrictions, high imports duties, a complex system of exports subsidies, an overvalued exchange rate and severe restrictions on Foreign Direct Investment (FDI). The liberalization, globalization and economic reforms undertaking since 1991 have influenced both India's industrial policy and external economic relations which including trade, foreign investment and financial relations. This has generated faster growth of international trading environment in the country.[1]

But according to the United States president Brak Obama India had emerged as a world's superpower in the starting of this century. But unfortunately situation is not so better for India which it should be. India and Pakistan, South Asia's two largest economies, resumed their composite dialogue in early 2011. The objective of this dialogue is to discuss mutual interests and concerns, and build a co-operative and productive relationship between the two countries. Stronger trade and economic relations have the potential to create stake holding in each other's success so that we can build a healthy relationship. The recent liberalization of trade and investment policies of both nations gives us reason to be optimistic, but it is crucial that the momentum of the last few months is not lost.[2]

International Trade

By definition international trade refers to the exchange of goods and services between one country to another country. International trade helps in improving welfare by allowing higher levels of consumption and investment than otherwise possible. In a labour surplus country like India it also helps in generating higher employment and higher wage rates with positive implications for income distribution and poverty, thus further raising the level of social welfare. The international trade has gathered momentum after the formation of General Agreement on Tariff and Trade(GATT) established in 1948 Geneva, compromising of just 23 countries at that time. But later in 1995 the name has been changed as World Trade Organization (WTO), which presently comprises of 139 countries. It stands to remove the barriers of trade between the countries consisting of tariff and non tariff barriers such as quota or import license. This has increased the dependence of member countries on the international trade, in the search of markets to strengthen their economies.[3]

International Trading Environment

The international trading environment includes important factors such as the trade policies, trade barriers and trade agreements, trading blocks cartels and multinational trade negotiations. International trading firms encounter three sets of environment and global environment. Foreign environment refers to the environment of the relevant foreign market, like the international trade regulations and other business environments of the foreign country concerned. Global Environment refers to those global factors which affect international trade such as WTO principles and agreements; other international conventions / treaties / agreements / declarations / protocols etc. relevant to the trade; economic and business conditions/ sentiments in other

countries, etc. Economic integration schemes are an important international business environment.[4]

Trade between India and Pakistan:

Contiguous countries around the world share a congenial trading environment, with high values of bilateral trade. However, trade between India and Pakistan has always been linked to the political relations the two countries share, than being merely governed by economic factors. Following the independence and partition in 1947, Indo-Pakistan trade fell severely; and came to a standstill for almost nine years in the aftermath of the war in 1965. A protocol on carrying on of trading relations was signed in 1974 on a list of mutually agreed items. In 1996, India accorded Most Favored Nation (MFN) status to Pakistan thereby offering Pakistan the same trading regime as it offers to any other country in the world. Pakistan, on the other hand, continued to allow imports of a limited number of items from India, collectively known as the positive list; although the number of items on the list has increased gradually.[5] The grant of MFN was linked to the resolution on the Kashmir issue. Moreover, India stopped trade via the air and land routes between 2001 and 2004 following the attack on Indian parliament in December 2001. In 2013, for the first time since 2004, cross border trade was altogether stopped following the incidence of cross border firing; with trade resuming within a few days time. Restriction on trade had been on several other counts as well, with the major ones being:

a) a restrictive maritime protocol until 2005 which allowed only Indian and Pakistani flagged vessels to carry cargo between the two countries, and not permitting the same vessels to carry consignments to a third country from the ports of either, b) presence of only one rail route for cargo movement between the two countries; and c) Absence of road-based trade route until 2005. This restrictive trading environment resulted in large informal trade flows between India and

Pakistan, with most of the trade taking place via third country ports such as Dubai. The process of trade normalization was set in motion in 2004 during the Commerce Secretary level talks on Commercial and Economic Co-operation between India and Pakistan. In this comprehensive dialogue, trade negotiations were to be discussed along with a dialogue on several other issues. This was the first step towards delinking trade negotiations from political issues. Since 2004, any major political event between India and Pakistan has neither met with any major impact on trading relations and bilateral trade has only been rising over the years.[6] In 2004, as members of the South Asian Association for Regional Cooperation (SAARC), India and Pakistan signed the South Asian Free Trade Agreement (SAFTA). The members of SAFTA include four least developed countries (LDCs) –Nepal, Bhutan, the Maldives, and Bangladesh; and three non-least developed countries (NLDCs) –India, Pakistan and Sri Lanka. SAFTA, as all other regional agreements under the WTO, required members to offer MFN treatment to each other. However, even after SAFTA was ratified in 2006, Pakistan did not accord MFN status to India and continued to trade on the positive list, allowing import of only 137 items from India via road, thereby making the route more restrictive. Thus with the two largest SAARC countries not trading under MFN rules, SAFTA has failed at helping normalize trade relations between India and Pakistan.[7]

The bilateral trade dialogue that had started in 2004 continued for four more rounds of talks until 2007 and resulted in three major outcomes- expansion of the positive list, opening of the road route in 2005, and amendment of the restrictive maritime protocol. As part of the Confidence Building Measures, in October 2008 the two governments permitted trade and travel across the Line of Control along Jammu and Kashmir. Following the Mumbai attacks in November 2008, the composite dialogue was stalled. It resumed after a hiatus of three years. During these three

years, however, no proactive measures were taken to block trade such as those initiated in response to the Parliament attack in 2001.

The fifth round of talks in April 2011 laid down the blueprint for normalizing trade between India and Pakistan. Perhaps what set the tone for the talks was the recognition of the necessity to promote bilateral trade to “build confidence, dispel misunderstandings and allay misapprehensions”. While the agenda was very detailed (covering inter alia the MFN issue, addressing non-tariff barriers, improving border infrastructure, customs liaison, harmonization of customs procedures, trade in electricity and petroleum products, co-operation in information technology, visas, bilateral investments, and opening of bank branches) the two negotiating points revolved around Pakistan granting MFN status to India and the latter addressing nontariff barriers faced by Pakistan in accessing India’s market. The Joint Statement issued in November 2011 laid down the sequencing and timelines for full phasing in of MFN status for India. In the first phase, Pakistan would graduate from the positive list to a small negative list specifying banned rather than permitted items. In the second stage, the negative list would be phased out; overall as well as for the road route on which trade takes place for only a fraction of the items on the positive list. These changes would usher in the full phasing in of MFN that forms an essential part of the trade normalization process.[8]

Adhering to the Joint Statement, in March 2012 Pakistan made a transition from the positive list approach to a small negative list of 1,209 items. However, it continued to restrict road-based trade by allowing only 137 items to be imported from India via road; while India took a number of steps to address Non Tariff Barriers (NTB’s). Since then, trade negotiations on MFN changed stance one more time. During the 7th Round of talks held in September 2012, India and Pakistan agreed to further deepen the preferential arrangements under SAFTA with India offering

concessions to Pakistan in exchange for Pakistan granting MFN status to India. In a major step, India pruned its sensitive list to 614 items. The current status as of July 2013 is that India would bring down its SAFTA Sensitive List to 100 tariff lines (from the existing 614 items); with Pakistan simultaneously granting MFN status to India, including the phasing out of negative lists and removal of restrictions on items traded by road.

Trends in Bilateral Trade

Bilateral trade between India and Pakistan increased by more than 9 times between the years 2000 and 2011. Total trade between the two countries was US$ 1.97 billion in 2011, of which India's exports to Pakistan were US$ 1.66 billion and imports US$ 313 million. Despite exporting only on the positive list, India has always had a trade surplus excluding mineral fuels with Pakistan; with the trade balance as a proportion of its total trade with Pakistan increasing from 55 to 68 percent between 2000 and 2011. However from 2009-12, the average annual rate of growth of imports from Pakistan has been 23 percent while that of exports has been just 9 percent, signaling some reversals in the trend. In 2011, India's top 3 exports to Pakistan at the classification of items included chemicals, textiles and vegetable products accounting for 68 percent of total exports to Pakistan. India's top 3 imports included mineral products, vegetable products and textiles accounting for 59 percent of total imports. At a disaggregated level, top commodities exported from India to Pakistan that year included, cotton, oil-cake, xylene, tomatoes, woven fabrics, chickpeas, polypropylene, rubber tyres, tea, fruits, and iron and steel containers. Cotton alone accounted for 16 percent of exports.

Trade Potential and Possibilities

This section examine the current trade trends, assess trade potential for India and Pakistan, examine the composition of the negative and sensitive lists, and assess the extent of trade

potential accounted for by these items. The protected sectors having the highest trade potential are identified and implications of opening up these sectors have been discussed. The sectors that are likely to face competition from imports once the negative and sensitive lists are further liberalized have also been identified. Trade possibilities and potential in the important service sectors have been examined as well.

Trade Potential in Goods

Several estimates have been made to predict the trade potential between India and Pakistan. But despite lower inter-country distances, transport and other transaction costs of trading are very high. Moreover, existing bilateral trade is limited to the positive list. Trade possibilities exist in items that two countries can import from each other instead of importing from elsewhere in the world. The results of this exercise show the existence of an estimated untapped bilateral trade potential of US$ 19.8 billion in 2011, which is 10 times larger than the current US$ 1.97 billion trade. Of this export potential accounts for US$ 16 billion, and import potential US$ 3.8 billion. The potential in mineral fuels is another US$ 10.7 billion of which export potential accounts for US$ 9.4 billion and import potential US$1.3 billion. This analysis includes only those items in the trade potential exercise in which the partner country is globally competitive. The intuition behind this is that items with a revealed comparative advantage to export to the rest of the world are most likely to be traded between India and Pakistan if there are trade possibilities. The total trade potential excluding mineral fuels falls to US$10.9 billion with the export potential accounting for US$7.9 billion and import potential accounting for US$3 billion. The trade potential from mineral fuels remains almost the same at US$ 10.4 billion. For India and Pakistan this untapped potential lies between US$ 10.9 billion and US$ 19.8 billion, excluding mineral fuels. Mineral fuels account for an additional export potential of US$10.4 billion to US$10.7

billion. After excluding mineral fuels, it is find that the difference is mainly due to lower estimates in India's export potential to Pakistan. India's export potential to Pakistan for products with comparative advantage is much lower at US$ 7.9 billion which is almost half of the total export potential of US$ 16 billion obtained. This implies that India has a comparative advantage in about half of the commodities it can potentially export to Pakistan. On the other hand, the import potential does not differ much in the two approaches, indicating that Pakistan has a revealed comparative advantage in most of the products which can potentially be exported to India. The export and import potential for Pakistan's negative and sensitive list; and for India's sensitive list is also calculated. India's export potential for Pakistan's negative list items accounts for 43 percent of its total export potential; and items on Pakistan's sensitive list under SAFTA account for 33 percent of India's total export potential. Export potential of items that are either on Pakistan's negative list or on the SAFTA sensitive list account for 56 percent of India's total export potential. India's import potential from Pakistan for items on its sensitive list under SAFTA account for 22 percent of India's total import potential. Thus, a substantial proportion of India's export potential is in products that are either on Pakistan's negative list for India or on the sensitive list under SAFTA. Similarly, a significant proportion of India's import potential is in items on the sensitive list under SAFTA.

Thus, even if trade is normalized, the two countries are likely to have limited preferential access to each other's markets. However, what is interesting is that when the export potential calculated after including only those items for which India has a comparative advantage to export to the world, 60 percent of the difference in estimates of export potential obtained in the account of items on Pakistan's negative/sensitive lists. The inference that can be drawn is that India is not competitive in a significant proportion of items on Pakistan's negative/ sensitive lists, hence

negating any rationale for these items to remain on Pakistan's negative/sensitive lists. Similarly, 68 percent of the difference in import potential that is observed after including only those items where Pakistan has a comparative advantage to export to the world, is accounted by items on India's sensitive list.

The three categories with the largest export potential from India to Pakistan are, textiles, chemicals, and machinery, mechanical appliances and electrical equipment accounting for 55 percent of total export potential. At a disaggregated level, largest potential items include petroleum oils, light petroleum oils, cellular phones, cotton, vehicle components, polypropylene, xylene, tea, textured yarn, synthetic fibre and medicaments. However, 13 of the top 25 products with the highest potential are currently on Pakistan's negative or sensitive lists or on both, making it difficult to realize the potential from these items. The three categories with the largest import potential include textiles, jewelry and precious metals, and base metals accounting for 52 percent of total import potential. At a disaggregated level the items with largest import potential include petroleum oils, jewelry, medical instruments and appliances, cotton, tubes and pipes of iron and steel, polyethylene , copper waste and scrap, structures and parts of structures, terephthalic acid and its salts, and sports equipment. Again 6 out of 25 products with the highest import potential are on India's sensitive under SAFTA.

India has a huge export potential in mineral fuels largely accounted for by petroleum oil and light petroleum oil. The potential for the former is US$ 7.7 billion and the latter is US$ 1.3 billion. India's import potential from Pakistan in petroleum oils is US$ 1.3 billion. Although both countries have export potential in petroleum oils, analysis at a more disaggregated 8 digit level reveals that Pakistan's major petroleum oil export is base oil while India's comparative advantage is in high speed diesel, aviation turbine fuel, fuel oil and lubricating oil.

Negative and Sensitive Sectors

Pakistan's negative list of 1209 items is specified at the 8-digit level of classification followed by Pakistan Custom's Office. This classification differs from the Indian classification at the same level of disaggregation. Analysis of the 1209 items indicates that auto components account for 32 percent of the items, followed by steel and paper products accounting for 11 percent and 8 percent respectively. However, it needs to be mentioned that in the process of aggregation, some products which were not on the negative list at the 8 digit level, got included as well. Hence, there were 788 items on Pakistan's negative list. Five categories, namely auto, electrical machinery, textiles, steel and pharmaceuticals accounted for almost 90 percent of the export potential on the negative list, within which, auto alone accounted for around 30 percent of the export potential on the negative list. In addition, India's export potential in items that are included in Pakistan's negative list is largest in automobiles (included largely in the category vehicles, aircraft, vessels and transport) accounting for 12 percent of India's total export potential to Pakistan. To identify specific commodities on Pakistan's negative list that are 'vulnerable' to competition from imports, for every item traded between India and Pakistan. Thus in the automobile sector which accounted for the highest export potential on the negative list, out of a total of 167 items, only 35 were vulnerable as these were items in which India is globally competitive but Pakistan is not. Similarly in textiles, out of 74 items on the negative list, Pakistan is vulnerable only in 25, or 34 percent of the items. India's export potential in items that are included in Pakistan's sensitive list under SAFTA is largest in automobiles (included largely in the category vehicles, aircraft, vessels and transport) accounting for 37 percent of export potential of sensitive list items 12 percent of India's total export potential. However, out of 70 items on the sensitive list in this category, Pakistan is vulnerable in only 19 items. In terms of

number of items, textiles sector was the largest accounting for 24 percent of total number of items on the Sensitive list. But these accounted for only 4 percent of India's export potential for items on Pakistan's sensitive list under SAFTA. Moreover, of the total 224 textile items on the sensitive list, Pakistan is likely to face competition in only 41, or 18 percent of the items. India's sensitive list under SAFTA has the largest number of items in the textiles sector which accounted for 30 percent of the total number of items on the sensitive list, while accounting for 62 percent of India's import potential for items on the sensitive list, and 14 percent of India's total import potential from Pakistan. Further, out of a total of 182 textile items on the sensitive list, India is vulnerable in only 45, or 25 percent of the items. It can hence be inferred that while Pakistan considers its automobile sector most susceptible to competition, India fears competition in the textile sector. However, the tendency for both countries has been to protect several tariff lines in which neither partner is competitive. In Pakistan the automobile sector is highly protected. The automotive industry was set up initially by Japanese, European and Korean manufacturers. These assemblers are supported by the auto component manufacturers or vendors. Some of the assemblers have joint ventures with the component manufacturers while others are independent. During 1985-2006 the industry adopted a 'Deletion Program' which mandated a compulsory localization of components over a period of time to provide protection to the local vendor industry.[9] In order to comply with WTO on Trade and Investment, the Deletion Program was abandoned but the sector continued to be protected by high tariffs. Pakistan currently imports completely-knocked down-kits (CKDs) and semi-knocked down kits (SKDs) from Japan, and parts from Thailand at higher prices than those from India. Opening of trade with India will make cheaper parts available to the industry. India's automobile vendor industry had a similar protected regime including an equivalent of Pakistan's Deletion Program for the automobile

manufacturers. With continuous liberalization India has become a global R&D and small-car manufacturing hub. Indian auto component manufacturers on the other hand are moving up the value chain and delivering complex products though largely for the domestic market.[10] The Government's Automotive Mission Plan (AMP) 2006-2016 visualizes India moving up the value chain and entering into R&D, design and manufacture of automobiles and auto components. Pakistan can learn from India's experience of opening up the automobile and auto component industry. Moreover, one of the major factors for the significant performance improvement in Pakistan's motor cycle industry is attributed to the opening up of Pakistan's market to imported Chinese components.[11] Thus there is a case for Pakistan to further liberalize its auto sector. Currently, there is hardly any direct trade in auto components between India and Pakistan and most of the trade is routed via Dubai, according to the Automotive Component Manufacturers Association of India.

On the other hand India's textile and clothing sector has been one of the most protected sectors in India. Until 2005, readymade garments were reserved for exclusive manufacture by small scale firms; large firms were not permitted to manufacture these items. To protect the domestic industry, textiles and readymade garments were also subjected to high import duties and specific duties which were applied in quantitative terms and not on ad-valorem basis. In fact some of the ad-valorem rates exceeded 300 percent. In 2005, the readymade garment items were removed from the reserved list thereby allowing large firms to enter into manufacturing. However, these items continued to be on the sensitive lists of India's free trade agreements even thought the rationale for protecting the industry was no longer there.[12] It was only in 2008 that India removed 164 textile items from the sensitive list for LDCs under SAFTA and offered duty free access. In 2011, all textile items were allowed duty free access from LDCs. Sri Lanka was

offered duty free access to 215 textile items under the India-Sri Lanka Free Trade Agreement in 2008. Similarly, a complex system of subsidies and taxes oriented the mill sector (spinning and yarn) powerfully towards the small-scale power-loom based weaving sector, which in turn was oriented primarily towards domestic consumption.[13]. In 2011-12, the mill sector accounted for only 5 percent of the total cloth produced by the mill and power loom sectors.[14]

However, there is a distinct difference in the fabric produced by the two sectors. While the mill sector produces high quality and high-value fabric, the fabric produced by the power looms is of low quality and commands a lower price. Pakistan on the other hand has a strong yarn and fabric manufacturing industry with India fearing is that imports from Pakistan would hurt its small and medium scale sector. Fabric imports from Pakistan are more likely to compete with the mill sector in India rather than the power loom sector thus providing no justification for India to protect the large firms from imports. Also, as noted above, India does not face much threat by opening up the Indian market to Pakistan's textile sector as only 25 percent of the textile items on India's sensitive list fall in the 'vulnerable' category. However it is agriculture that is the main point of contention in the ongoing trade talks. Even though farmers in Pakistan are raising concerns over unfair competition from Indian imports of agricultural products while they enjoy various subsidies, the negative list has very few agriculture items. India's export potential in tobacco items which are on negative list is less than 1 percent of the total import potential of items on the negative list. All the remaining agricultural items have been removed from the negative list. However, farmers fear that if the land route is opened to agricultural imports, then they would not be able to compete with Indian products.[15] Pakistan has always been concerned that due to high subsidies, the prices of agricultural commodities are lower in India and therefore opening up of trade would have a negative impact on the domestic producers. While India does

offer subsidies, its non product specific subsidies are below 10 percent of the value of agricultural output, abiding by the WTO rules.[16] Further, it needs to be noted that prior to 1996 even when trade between the two countries was limited to a handful of items on the positive list, agriculture was part of this positive list, as it was not only an important means of overcoming short-term fluctuations but was also important for maintaining domestic price stability. At the time when Pakistan's positive list expanded to 1963 items, 156 agricultural commodities formed a part of this list. While Pakistan may have genuine concerns regarding any adverse impact on its agriculture sector due to a surge in agricultural imports from India, the solution should be to seek safeguards within the WTO system and under SAFTA, rather than imposing a total ban on agricultural commodities from India.

Trade Possibilities in Services

There are additional trade possibilities in services sector which is becoming increasingly important in the economies of India and Pakistan. In 2011-12, this sector accounted for 59 percent of India's GDP and 54 percent of Pakistan's GDP. Three sectors, where there is potential include information technology and Business Process Outsourcing (BPO), health services, and entertainment services. India's IT and BPO sector revenues were US$ 87.6 billion in 2011-12. Software exports in 2011-12 were US$69 billion compared to US$59 billion in 2010-11. Exports dominate the industry and constitute about 78.4 percent of total industry revenue. Indian IT service offerings have evolved from application development and maintenance to emerge as full service players providing testing and infrastructure services, consulting, and system integration.[17] The BPO sector which initially offered only low value services is now characterized by greater breadth and depth of services. Although the IT industry in Pakistan is in its infancy, it is growing at a fast pace. IT exports in 2011 were US$ 440 million, up from US$ 432 million in 2013

previous year. This is one of the potential areas which could be exploited as both countries are competing in information and information services. India and Pakistan can establish joint ventures. While Pakistan could provide professionals at lower wages, Indian companies could help in procurement of international contracts.[18] Pakistan is emerging as an exporter of specialized software services such as gaming and animation, financial services and healthcare, which Indian companies could import. The two countries could also gain if India sets training institutes in Pakistan, or if professionals from Pakistan come to India to get professional training. The BPO segment in Pakistan is also growing. Government incentives to the international outsourcing community include 100 percent equity ownership, 100 percent repatriation of capital and dividends, and income tax exemption for IT companies till 2016. India could collaborate with the BPO firms in Pakistan to offer more value added services in this segment.

Healthcare service is another area in which there are opportunities for both countries. India has emerged as an important destination for provision of medical services due to affordable cost of treatment and advancement in the field of medicines. Several Pakistani patients have been visiting India for medical treatment like liver transplant, open heart surgery and kidney transplant.[19] Other specialty treatment is also being offered to Pakistani patients. For instance, the Mumbai Obstetric and Gynecological Society is providing treatment for infertility to Pakistani couples. Despite a relatively tight visa regime, the number of patients coming from Pakistan to India is on the rise. According to a report, the Indian High Commission in Islamabad issued 1,992 medical visas to Pakistani citizens during 2008-2010. In addition, 2,917 visas were issued to medical attendants during the same period**.** There is a vast scope for cooperation in the health sector. In February 2012, a group of Indian and Pakistani doctors jointly performed a

complicated liver transplant procedure in a Lahore hospital for the first time thereby opening new avenues for co-operation in the area of healthcare services.[20]

There are trade possibilities in the entertainment industry as well. India and Pakistan share a common language and culture, thus providing scope for trade and co-operation in the film industry. India is the second largest producer of movies in the world, while Pakistan produces very few movies. Pakistan had imposed a ban on screening of Indian films in 1965 following the Indo-Pak war. The purpose of the ban was largely to protect the domestic film industry. However, despite the ban the Pakistani film industry has not done well.[21] The ban was lifted in 2008, but since then there has been uncertainty in the policy as several ad-hoc steps have been taken to ban Indian movies on a case by case basis. Through the years, the ban has been practically ineffective as the demand for Indian movies in Pakistan is met through pirated DVDs and satellite cable broadcasts of Indian films. There is an interest in India and Pakistan for each other's music- both audio and visual. There is also an interest in Pakistan to watch Indian television serials and in India to watch Pakistani plays. However, Pakistani entertainment channels are not broadcasted on Indian channels whereas several Indian channels are broadcasted in Pakistan. The trade potential in the entertainment industry particularly in films, television and music can be tapped by encouraging joint productions. Removing the ban on screening movies would benefit both the countries. Exchanging broadcasting rights to telecast each other's programmes on television is yet another trade opportunity for India and Pakistan.

Transport and Transit

Most discussions and studies on the transport issue have focused on the impediments related to the land route. While the sea route has always been operational, it went unnoticed due to the restrictive maritime protocol. This protocol allowed only Indian and Pakistani flagships to carry

cargo between India and Pakistan. This arrangement restricted competition from foreign vessels, and therefore resulted in high sea freight rates being charged by Indian and Pakistani vessels. The amendment of this protocol in 2005 brought sea trade between the two countries under global maritime arrangements, leading to greater competition, and therefore, to a considerable reduction in costs for sea-based trade between Mumbai and Karachi. It is not surprising that in 1995-96 when the road route was closed, trade by rail accounted for 63 percent while that by sea accounted for 33 percent of the total trade between India and Pakistan. By 2011-12 the share of different modes in total trade between the two countries changed substantially due to the opening of the road route and the liberalization of the sea trade. The share of trade by rail fell to 15 percent, while that by sea increased to 60 percent. Share of trade by road increased from zero percent in 1995-96 to 17 percent in 2011-12. Moreover, what is striking is that for both exports and imports, apart from a few commodities like dry dates and cements, most of the top commodities are traded via a single mode of transport, either road, rail, sea or air. The opening of the road route between India and Pakistan after 58 years was a historic move. India and Pakistan share a 2912 kilometer long border. The significance of this move can be better understood when compared with cross-border transport protocols that India has with Nepal. India and Nepal have the most liberal transport protocol which permits trucks from the two countries to move into each other's territories. This is because when trucks move from one country to the other, the local mafia extorts money from the foreign trucks.

Thus, transshipment continues to occur because these informal payments are higher than the cost of transshipment. Hence there is a need to strengthen institutions at the border for effective implementation of policies. On the other hand, the opening up of the road route between India and Pakistan has met with relatively little opposition. Indeed, the institutional framework

supporting trade between the two countries is strong enough to counter lobbyists and interest groups that may have resisted such a change. This raises immense hopes for successful implementation of further trade-facilitating measures at the land border between India and Pakistan. Amritsar and Lahore are the two major cities on either side of the border separated by a distance of only 54 kilometers. Hence, the transport costs for goods moved via land route between northern India and northern Pakistan could be substantially lower than the sea route. Recognizing the importance of the land route, India opened an Integrated Check Post (ICP) at Attari in April 2012, with new facilities including a trade gate that would house all trade activities under one unit including warehousing and other facilities. Timings for trade were increased to 12 hours every day for all days of the week. While the ICP is operational, the two most important facilities that are underway include automated systems for electronic filing of customs documents through the Electronic Data Interchange (EDI) facility and installation of truck scanners. This is a marked change from the past, when there was only one gate for trade and for passengers, trade timings were limited to only 7 hours daily, and no warehousing facilities were offered. In a short span of just six months – between April and October 2012, the warehouse has reached full capacity. This in turn limits the entry of trucks from across the border. The question is whether these facilities will be able to bear additional cargo load which is likely to occur for two reasons- Pakistan's move to normalize trade on the road route by allowing all items to be imported from India via road, instead of the existing list of only 137 items; and a likely shift in trade from the sea to road route due to lower transaction costs in the latter. The ICP, when conceived by the Indian government clearly did not envisage such a paradigm change in trade between the two countries. The trade would increase further if the two governments agreed to move containerized cargo by road. Allowing these trucks to move in each other's

territory is yet another measure that would reduce transaction costs further. The two governments are also considering opening up of new road routes. The option of opening the Munabhao-Khokhrapar road route was discussed in the seventh round of talks between the two governments.

The rail route was the dominant land-transport mode for India-Pakistan trade for several years. The rail route's relative importance over the sea and road route has declined as it continues to be limited in its reach. Goods transported by the goods train, often referred to as "interchange train", or by parcel wagons; are attached to the Samjhauta Express passenger train which runs on a biweekly basis carrying 6 to 10 parcel wagons. Since the capacity of Samjhauta Express is limited, most of the rail cargo is carried by the interchange train. Earlier studies have pointed out that the existence of only one rail route through the Attari/Wagah border, poor quality of rolling stock and restriction on the type of wagons are some of the problems that traders faced.[22] Also, traders in Kolkata, located in eastern India, find it difficult to trade through the Attari/Wagah land border because of lack of information on how to trade by the rail route. Therefore, they send consignments by sea to Colombo, which are then transshipped to Karachi.[23] Since 2007, there has been deterioration in interchange train services. Goods by the interchange train move only between Amritsar and Lahore through the Attari rail station, with just the Pakistani wagons plying on this route, unlike earlier when Indian wagons also plied on the rail route. Cargo for export either comes in Indian wagons up to Amritsar where it is unloaded and then loaded onto Pakistani wagons; or it is loaded on trucks to be sent through Wagah. Transshipment of cargo from Indian to Pakistani wagons or onto trucks adds considerable time and cost to transporting goods. Even though infrastructure has improved with the ICP, these facilities do not extend to rail cargo movement. The railway line is about three kilometers away from the ICP. The agenda

for improving rail transport remains largely unaddressed. While the 7th round of talks agreed to increasing the number of interchanges to 3-4 in a day and allowing high capacity wagons to ply, the discussions so far have only covered the immediate needs of facilitating rail transport.

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 Afghanistan for its exports. However, Pakistan offered transit rights to Afghanistan's exports through its territory to reach the Indian market in 1948. In July 2010, Afghanistan and Pakistan signed an amended transit trade agreement, the Afghanistan-Pakistan Transit-Trade Agreement (APTTA), which provides for an increased number of transport routes available to trucks from Afghanistan and Pakistan. 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 dialogue agenda. This would also have huge implications for reviving the Afghan economy. Afghanistan can gain little through trade given its limited export capability but it can take advantage of its geographical location by converting into a logistic hub and offering a whole range of logistic services that could help transport goods between South and Central Asia. It follows that India should also allow transit facility to Pakistani goods for accessing the Nepal and Bangladesh markets. There is need to develop a long term vision and plan for road and rail cargo movement by the land route. Limiting the opening of the land route to just the land border is not enough. Freight costs are often determined by the freight trade balance between two countries. Since India has a trade surplus with Pakistan, India's cargo trucks/wagons moving back from Pakistan will not be fully loaded, with empty wagons adding considerably to transaction costs. However, if the trucks/wagons are allowed

cross border movement and multimodal-transportation is permitted, cargo balancing could be achieved by linking the sea ports of Mumbai and Karachi through the land route, with the sea ports largely connecting the rest of the world. Similarly transit through Pakistan can link Indian sea ports with Afghanistan and to rest of Central Asia through Pakistan.

Non-Tariff Barriers

For many years Pakistani government has expressed that their businessmen face nontariff barriers in accessing the Indian market. On this issue, it was recognized by both countries during the talks that there were no Pakistan-specific barriers but a general lack of awareness amongst Pakistani businessmen on the regulatory regimes in India. In a study conducted in 2008 for the Task Force on Non Tariff Measures (NTMs) it was found that while these NTMs were not discriminatory, the procedures relating to product standards were cumbersome, some regulations lacked transparency, and there were problems related to recognition of standards. The two governments however felt that it was important to address the perceived barriers as well. In September 2011, the Indian government arranged interactive sessions between the Indian regulators and Pakistani businessmen in New Delhi to help increase awareness amongst the latter on India's regulatory policies. Such a session was subsequently held in Pakistan in January 2012.[24] This government-to-business interaction is an innovative and effective method of addressing information gaps on the regulatory environment of India and Pakistan.

Recently, the Trade Development Authority of Pakistan supported experts to undertake a study that identified potential products for exports to India, including tariff and nontariff barriers that Pakistani businessmen faced. The findings of the study were subsequently disseminated across ten cities in Pakistan to inform the businesses on India's regulatory regimes. Some of the reported barriers included over valuation of goods, tedious packaging and labeling requirements,

access to limited number of ports for some products, lack of testing facilities at ports, inadequate infrastructure, mishandling of goods, and theft of cargo at ports. Businesses were also educated on the use of WTO compliant trade defense instruments and how they could be used to restrict imports which could hurt the domestic industry. Such a government supported awareness initiative, if done on a sustained basis every few years, could have a long term impact on dispelling notions and misconceptions of perceived barriers amongst businessmen willing to access the Indian market. It shall also help in raising awareness on genuine non-tariff barriers, and equipping businesses to deal with expanded imports if they hurt their domestic industry. In another initiative to address non-tariff barriers, Governments of India and Pakistan signed three agreements in September 2012; including a customs cooperation agreement to help avoid arbitrary stoppage of goods at each other's ports, a bilateral cooperation agreement on mutual recognition between 'Pakistan Standard and Quality Control Authority (PSQCA)' and 'Bureau of Indian Standards (BIS)'; and an agreement on redressal of trade grievances between Pakistan and India. Non-tariff barriers of a different nature were identified in some studies.[25] It was found that Pakistani consignments were subjected to excessive checks- usually due to security concerns causing harassment to genuine traders. Marketing and labeling issues relating to the perceived 'image' of Pakistani goods was also pointed out in recent studies. For instance, the label on Pakistani bed linen was changed to European and Indian labels for sale in the Indian market. Holding exhibitions, such as the Pakistan Mega Lifestyle Exhibition held in Delhi in April 2012 and the Made in Pakistan Expo held in August 2012 in Mumbai, could aid acceptance of Pakistani goods in India. In September 2012, the Pakistan Fashion Design Council opened an outlet in an up-market shopping complex in New Delhi. Such steps will certainly raise awareness among Indian consumers about Pakistani products. Indian products too face a labeling issue,

with their Pakistani counterparts advising on dropping the 'Made in India' label to accentuate sales in Pakistan. However, newer products such as sweets and snacks, manufactured by a large Indian firm, have made a successful entry in the Pakistani market under the Indian label. Though measures to mitigate NTB's have been undertaken, addressing them is not a one-time effort. India and Pakistan need to identify, deal with, and address new NTB's on a continuous basis, as and when they are raised.

Informal Trade

The restrictive trade environment, has led to large informal trade flows between India and Pakistan, estimated to range from US$ 250 million to US$ 3 billion. The most detailed study on Indo-Pakistan informal trade estimated its value at around US$ 545 million in 2005.[26] Pakistan's imports from India are estimated to be around US$ 535 million and exports to India US$ 10.4 million. The main import items from India, via informal channels, are cloth, tires, pharmaceuticals, textile, machinery, cosmetics, livestock and medicines; accounting for roughly 80 percent of total informal import value. Pakistan's informal exports mainly consist of textiles; accounting for approximately 90 percent of the total informal trade. It is interesting to note the modalities of India-Pakistan informal trade, with most of the trade flowing via third country. Khan estimates trade via Mumbai-Dubai- Karachi route to be around 88 percent of total informal trade, and the remaining as cross border informal trade through the Amritsar-Lahore and Sind-Rajasthan border routes.[27]

However, almost 51 percent of informal trade taking place via Dubai does not reach Karachi directly as goods are transshipped from India to Dubai from where they are shipped to Bandar Abbas in Iran and then moved further via land across Afghanistan, to finally reach Pakistan. Only about 18 percent of informal trade takes place through the sea route from India to Karachi

via Dubai. While these estimates are dated, they provide useful insights into the functioning of informal trade markets. It is reasonable to assume that individuals trading through the informal channels have devised parallel institutional mechanisms for contract enforcement and dispute settlement. Also, the smooth functioning of such markets shows that traders have developed efficient mechanisms for obtaining information on quantities and commodities to be traded and mitigating risks that might arise in the unofficial transacting environment.[28]

The move towards trade normalization and a parallel reduction in tariffs and non-tariff barriers would certainly lower informal trade flows between India and Pakistan. Trade through Dubai is likely to decrease sooner if there are active channels of information that would bring buyers and suppliers on either side together in order to conduct trade directly with each other rather than through third parties. Elimination of the negative list would also allow export of many items that had to be routed via Dubai and other informal channels of trade. Until all such measures are fully implemented, informal and formal trade between India and Pakistan are likely to co-exist.

Visas

A lot needs to be done in simplifying the visa regime between India and Pakistan. Grant of city-specific visa, the requirement of police reporting on arrival and before departure, the restriction on going beyond the port of entry, and delays in getting a visa have limited market access for aspiring traders. Consulates in both countries have exercised tremendous discretionary power in granting visas and waiving visa requirements along with allowing some traders to be exempted from scrutiny by the Ministry of Home Affairs in India and Ministry of Interior Affairs in Pakistan. They have also allowed extended period of stay, exempted Interviews with traders in Dubai in 2012 traders from police reporting, and removed restrictions on the number of cities that can be visited. Selected traders who are beneficiaries of such largesse can make repeated

visits and enhance their Pakistan specific trade information; which remains inaccessible for other aspiring traders due to restricted market access, lack of transparency, market imperfections, and information asymmetries. However, 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. The new visa agreement was signed between India and Pakistan in September 2012. The agreement introduces measures to ease travel of tourists, pilgrims, elderly and children to facilitate people-to-people contact between the two countries. The business visa has also been made more liberal, allowing one year multiple entry visas for upto 10 places with exemption from police reporting for those reporting a turnover of at least Rs. 30 million or equivalent in Pakistani Currency. The new visa regime is a step forward towards easing the channel for information exchange on trade-related matters between India and Pakistan. As a next step the countries could consider the use of electronic systems that would assist in having adequate and effective security systems in place while at the same time allowing genuine traders to trade across borders.[29]

Institutions Engaged in Trade Normalization

Trade normalization efforts have been driven at multiple levels on sides of India and Pakistan. All bilateral talks are spearheaded by the Ministry of External Affairs. Other important government departments involved are the Ministry of Commerce and the Ministry of Home Affairs. The former is leading the trade negotiating agenda while the latter has the primary responsibility of maintaining security. In India, two key functions performed by the Home Ministry in the context of trade include issuance of visas and border management. As part of its border management functions, Land Ports Authority of India (LPAI) was set up in April 2012 to

provide cohesive management of cross-border movement of people and goods. On the side of Pakistan, the road port is managed by the National Logistics Cell, which falls under the purview of the Ministry of Defense. With respect to their bilateral visa regime, the Ministry of Home Affairs in India and Pakistan has taken progressive steps. The bureaucracy in India, arranged in vertical and hierarchical levels, seems to have accepted the pace of change set in motion by the trade normalization process. Even though, the issue of cross border terrorism often appears in bilateral talks, so far there has been no attempt to link it to the trade agenda. The Indian and Pakistani military forces are also not seen as adversaries in the trade normalization process. The involvement of NGO's too is quite limited. The business communities in both countries have been actively engaged in pursuing the trade liberalization agenda through the Chambers of Commerce for several years. In India, the Federation of Indian Chambers of Commerce and Industry (FICCI), the Confederation of Indian Industry (CII), the Associate Chambers of Commerce (ASSOCHAM), and the Punjab, Haryana and Delhi Chambers of Commerce and Industry (PHDCCI) have taken the initiative to facilitate cross border interactions between business delegations and communities to assess trade possibilities. Since the Summary Of Proceedings, Regional Chambers of Commerce Roundtable, Lahore January 10, 2013 initiation of the trade normalization process, such cross-border interactions have increased manifolds.

Academic discourse in India has largely focused on the political issues between India and Pakistan to have implications on trade normalization between the two countries. Until recently, the print and visual media too were engaged largely in 'negative' reporting as there was a tendency to report conflict rather than any peace initiatives undertaken by the two sides. Even the proposed grant of MFN status did not make headlines in any of the major news dailies. There is however, an evident shift towards positive reporting in the media on peace initiatives and trade

co-operation which can have a huge impact on the perceptions of civil society towards relations shared by India and Pakistan.[30]

What is Immediately Required?

One of the most strategic issues needs immediate attention is MFN. On the issue of the Most Favored Nation (MFN) status and other trade requirements, India in principle granted MFN treatment to Pakistan in 1995-96 but has no list of permitted or forbidden products. Pakistan has not extended normal GATT/WTO rights or the MFN in principle to India, but maintains a `permissible list' of 600 items that may be legally imported from India. A glance at the permissible items indicates that most of items are chemicals, minerals and metal products. The finished products are not part of this list which should have been the part of list and that are the backbone of trade. Added to this, the items that are part of permissible list but invite a high tariff are cardamom, tea and electrode of graphite. There are non-tariff barriers on the items like beedi wrapper leaves, cardamom, tea, ginger (fresh) and synthetic organic coloring agents.

Emerging Issues:

The most vital and strategic issues to be resolved between India and Pakistan are lack of road trade routes, irregular railway traffic and an expensive shipping route. These issues are required immediate attention of both the countries. If these issues are not solved there are chances that global competitiveness would in danger as the cost of trade would go enormously. Further under South Asia Preferential Trading arrangement (SAPTA), India has extended to Pakistan tariff concessions on 393 items up to third round of SAPTA, but Pakistan has provided to India tariff concessions only on 248 items. But 73 of these 248 items cannot be imported from India as they are on the banned list... Further, not much headway has been made in any of the initiatives like SAPTA, SAFTA, Investment Promotion and Protection Treaty, Arbitration, and Regional Motor

Vehicular Treaty, etc are essential for speedy growth in Indo-Pakistan Economic Relations. There should not be “myth” but “reality” in this regard. Corporate leaders are more capable of rewriting history than the political leadership of both India and Pakistan. People or a media-led civil society movement is also critical as people are the most important stakeholders and their will needs to be galvanized. India and Pakistan are living in unpredictable times with the international system in a constant state of flux on several horizons that is further endangering the international security system. It is imperative to create interdependence and partnership based on solid bedrock of commerce so that business ties act as a check to Government’s initiating hostile action. Burden of peace is heavier on South Asia as it houses half the world’s poor. Peace is no longer a luxury but a prerequisite that every member of the country or society needs to strive for. While responsibility rests heavier on the privileged, changing the public mindset requires initiatives from the full spectrum of society. Industry has an important role and contribution in brining an improvement in relationships and bilateral linkages. There is an immediate need to permit transit trade to Afghanistan and Central Asia, replace the positive list with a negative list of goods beyond which it would permit imports from India and improve its infrastructure for trade and transport.

South Asia is the least integrated region compared to East Asia, Latin America, Europe and Central Asia, Middle East and North Africa or sub-Saharan Africa. Other successful regional cooperation and integration initiatives have demonstrated that regional cooperation is a win-win and positive-sum situation that is beneficial to the entire region. There is no reason why SAARC nations in general and India and Pakistan in particular cannot replicate such a model which has become sine-quo-non. It is true in all senses that geographical proximity offers tremendous scope to reap the benefits of cheaper transportation costs and trade complementarily in goods in which

either country has a comparative advantage. Despite the shadow of two world wars and the cold war, unparalleled development has taken place in the last years. The sky is the limit for expansion of bilateral economic activity. Let us together step out of the old and into new.

India-Pakistan Investment Flows:

In recent months India and Pakistan have unveiled a number of unprecedented trade and commerce initiatives aimed at normalization of bilateral economic relations. The two countries now seem to be at a point where both understand the importance of economic engagement as a means to improve peace prospects. The announcement by the Indian Government on August 1, 2012, to allow Foreign Direct Investment (FDI) from Pakistan has given yet another fillip to Indo-Pak economic relations in the somewhat uncertain environment that was beginning to emerge. There are still some unanswered questions, but once addressed India and Pakistan would have covered yet another milestone in their journey towards normalizing trade and economic relations. Until recently, India had Sri Lanka, Bangladesh and Pakistan on the negative list; however in 2006 and 2007, India permitted FDI from Sri Lanka and Bangladesh respectively, making Pakistan the only country from where India did not permit any FDI inflows. The recent announcement to allow FDI from Pakistan marks a significant change on two counts. First, India no longer has any country on its negative list of foreign investors in its FDI policy. Secondly, the announcement has restored confidence among those who perceived a slowdown in the momentum of normalizing the economic relationship between the two countries following a series of events starting May 2012. This included the postponement of the liberalization of the visa regime between India and Pakistan and the delay in following up on India's Commerce Minister Anand Sharma's promise in April this year to allow FDI from Pakistan.

Another dampening factor was the "inconclusiveness" of energy talks that the two countries had started in March this year. Trade in energy can bring about a quantum jump in India-Pakistan trade. The opening of a US$ 4 billion plant in April 2012 on the northern border with Pakistan at Bhatinda by Mittal Energy Investments and Hindustan Petroleum was expected to gain significantly from the energy talks. The slowdown in the process of strengthening trade and economic relations between the two countries was reversed on August 1, 2012 when India's Department of Industrial Policy and Promotion (DIPP) notified changes in the consolidated FDI policy to allow investment from Pakistan in sectors/activities apart from defense, space and atomic energy through government route and made the requisite amendment. Following this, India recently removed Pakistan from the negative list under the Foreign Exchange Management Act, paving the way for investment from Pakistan. Even in the case of outward FDI flows from India to Pakistan, the FEMA regulations had been an inhibiting factor. Pakistan, on the other hand, has maintained a liberal investment policy with no restrictions on inward investment from, and outward investment, to India. In this context the circular issued by the Reserve Bank of India (RBI) allowing Indians to invest overseas in Pakistan under the "government" route is an important confidence building move. This opening up of investment opportunities has been hailed by businesses on both sides and will likely open up other multi-dimensional opportunities. There is no doubt that encouraging two-way investments will enhance business confidence on both sides. An enabling business environment between the two countries will promote joint ventures and allow firms to access technologies, which in turn will lead to productivity improvement, generating growth and employment opportunities. The private sector is expected to step in to assess bilateral investment possibilities.

Though at the moment it appears that investment possibilities for Pakistani investors are limited. If we look at the year 2011, Pakistan's total outward FDI flow was only US$ 62 million while India's was US$ 14.8 billion. Further, Pakistan's inward FDI flow for 2011 was US$1.3 billion while that of India was US$31.6 billion. The chambers of commerce in the two countries have identified clothing, clothing accessories, fabric, surgical instruments, and cutlery as some of the possible sectors for Pakistani investment. There are larger possibilities for Indian investors in Pakistan in sectors such as chemicals, pharmaceuticals, automobile components, and information technology. In the seventh round of talks on Commercial and Economic Co-operation held in Islamabad between the commerce secretaries of India and Pakistan on September 20-21, 2012, the Pakistani side recognized efforts by India to remove restrictions on inbound and outbound investment to Pakistan. However, they raised concerns about the "government" route and its implications for Pakistani investors in India.

Under India's FDI policy, an Indian company can receive foreign direct investment under two routes – automatic route and government route. According to the RBI guidelines, under the automatic route, investors do not require any prior approval from either the government or the Reserve Bank of India. On the other hand, under the government route, investors require prior approval from the Foreign Investment Promotion Board (FIPB), Department of Economic Affairs, Ministry of Finance. The FIPB is the government body that provides a single window clearance for foreign investment proposals into the country that is not permitted via the automatic route. This agency discusses and examines proposals for investments in sectors that are not allowed via the automatic route under FDI policy. For investors from Pakistan and Bangladesh, the "government route" applies to all sectors. The investors from these countries are concerned on two fronts – transparency and time taken for approvals. However, it needs to be

noted in India an e-filing facility was introduced in March 2012 to enhance the efficiency and transparency of decision-making under the government route. Under this facility, investors can apply for approvals directly and complete applications filed three weeks prior to a scheduled FIPB meeting are taken up for consideration. The FIPB meetings are held on a regular basis, usually once in 4-5 weeks, to clear applications. The committee declares the approved cases, deferred cases, and the cases that have been rejected. It also provides comments to enable investors to revise and resubmit their applications. These decisions are publicly available on the FIPB website. These systems in place for investments under the government route will enable the two countries to assess the status of applications made by Pakistani investors on a regular basis.

The next step for the governments of India and Pakistan should be to set up an institutional mechanism that would guarantee each other's investments. The countries should work towards signing a bilateral investment treaty that protects and promotes investments of investors on a reciprocal basis and includes provisions on fair and equitable treatment, protection from expropriation and national treatment. Another important issue that needs to be addressed in facilitating bilateral trade and investment between the two countries is allowing banking operations on a reciprocal basis. This would also promote further economic interaction. Action on this front has already been initiated with the commencement of talks between the Reserve Bank of India and the State Bank of Pakistan earlier this year. As India moves towards completing the important task of liberalizing investment flows, it will reinforce its commitment to the trade and investment agenda laid down by the two countries in April 2011. Stronger and deeper economic ties will not only benefit the two countries, but will also serve as a powerful means of confidence building and, in time, of peaceful bilateral relations.[31] Like many other

developing countries, South Asian nations have been experiencing increased FDI inflows over the past decade. Compared to total inflows, intra-regional flows of FDI seem to be increasing, but still accounted for only about 5 percent of total cumulative FDI in the past three decades. India accounts for over 90 percent of these FDI flows in South Asia.

Prospects for Indian Investment in Pakistan

Pakistan's geographical location, liberal foreign investment policy, conducive business environment, and a young skilled workforce make it an investor-friendly destination. Strategically located in South Asia, Pakistan is at the crossroads of China, the Central Asian Republics (CAR), and the Gulf States. Pakistan's large market offers huge opportunities to investors from India in terms of the easy access it can provide to markets in Iran, Afghanistan, the Middle East, and CAR. Pakistan's foreign investment policy has been designed as a comprehensive framework to create a conducive business environment to attract FDI. The investment policy offers foreign investors several incentives with respect to tax and to regulations on repatriation of capital and profit. Pakistan has enacted the Law of Special Economic Zones[32] that allows the creation of industrial clusters and offers liberal incentives, infrastructure, and investor facilitation services to enhance productivity and reduce the cost of doing business. An added advantage is its large trained and skilled English-speaking labor force. The consumer market in Pakistan is also growing at a rapid pace and the potential to tap market opportunities provides strong grounds for FDI flows from India into Pakistan.

Indian investment in Pakistan can benefit from several country-specific advantages. The common culture and language between the two countries can immensely facilitate business cooperation. The language spoken is the same in the two Punjabs in the two main cities of the

two countries, Karachi and Mumbai, Sindhi is spoken. There is a certain sense of connect with people across the border. Smooth communication channels help in business interactions by reducing entry and transaction costs. Given the enormous benefits of FDI, increased investment flows between India and Pakistan could be mutually beneficial for both countries. However, the benefits of FDI seem to be larger for Pakistan than for India. A liberal investment regime for FDI flows from India will enable Pakistan to tap into the pool of Indian skilled workers and technology to improve international competitiveness of Pakistani firms.[33] Also, increased investment can boost Pakistan's economic growth and help it overcome the domestic challenges its economy faces. Overall, an improvement in the FDI scenario between India and Pakistan will help strengthen bilateral ties. Against the background of prospects for Indian investment in Pakistan, the following sub-sections analyze the growing importance of India as an overseas investor and Pakistan as an investment destination.

Potential Areas for Indian Investment in Pakistan

As India and Pakistan compete to sell their products in the international market, there are areas in which the two countries can complement each other's needs. There is general interest among businessmen on both sides to invest in the other's country. There is greater interest from the Pakistan side to invest in India in sectors such as cement, hotels, and textiles. There is a general expression of interest by large Indian business houses such as the Tatas and Godrej to invest in Pakistan. Companies such as Dabur already operate via Dubai to cater to the Pakistani market. In September 2013, the first India-Pakistan joint venture took place. A furniture-making firm in Lahore, IWM (Interwood Mobel) Private Ltd.[34] and Noble Trans-links Private Ltd. of Amritsar jointly set up a firm called IWM Interwood Mobel Private Ltd. The stage has been set for investment by these two companies and this precedent should be followed with more such

investments. During the course of our industry consultations, interaction with policymakers, and review of research reports, we identified sectors for possible collaboration within three broad categories.

Primary Sector

India and Pakistan are both principally agrarian economies with agriculture contributing 13.7 percent and 21.4 percent to GDP, respectively, in the two countries in 2012–13.[35] Agriculture, with its allied sectors, is unquestionably the largest livelihood provider in both countries. Most industries also depend on this sector for their raw materials. There are considerable opportunities for investment in agriculture and processed foods. Within agriculture, there is tremendous scope for investments/joint ventures in inputs such as seeds, agricultural equipment, and technology.[36] Further, the mining sector offers scope for investment. Based on available information, more than 6,00,000 sq. km of outcrop potentially holds metallic/non-metallic mineral deposits in Pakistan. Except for oil, gas, and nuclear minerals regulated at the federal level, minerals are regulated at the provincial level. The Federal and Provincial governments jointly set out Pakistan's Mineral Policy in 1995, providing the appropriate institutional and regulatory framework and an equitable and internationally competitive fiscal framework. The enforcement of the Mineral Policy has paved the way to expand mining sector activities and attract international investment in this sector. Although the opportunity for Indian investment in the mining and mineral sector is good, past experience may deter investors from investing here. In December 2009, the authorities in Balochistan Province passed a motion and threatened to terminate the exploration mining license of the Reko Diq copper and gold mine held by Canadian Barrick Gold Corporation and a Chilean copper mining company. The threat to cancel the license was reportedly on the grounds that the mining lease application was incomplete and

not legally compliant with mining laws.[37] However the Balochistan government called the move a step towards getting control over provincial resources. Despite timely intervention by Pakistan's federal government, the dispute sends a negative image of the otherwise lucrative and welcoming attitude of the government toward FDI and may deter Indian investment in this sector.[38]

Secondary Sector

Pharmaceuticals, textiles, transport, and energy are a few sectors that offer investment potential to Indian investors in the secondary sector. In the pharmaceuticals sector, there is scope for collaboration in bulk drugs and expansion of formulation and health products. Indian pharmaceutical products are cheaper than Pakistani pharmaceutical products and Pakistan's pharmaceutical regime is not strictly regulated for domestic production. There is scope for setting up JVs in Pakistan for sharing technical know-how in this sector. The Indian pharmaceutical industry can provide the necessary support and assistance to Pakistan to expand its industry. Further, this will have a positive impact on Pakistan's industrial growth and help meet the challenge of providing cheaper drugs to Pakistani citizens. The major Indian pharmaceutical player, Biocon, has granted an exclusive license to enter the Pakistan market through a licensing arrangement with Ferozsons Laboratories, Pakistan.[39] There is scope for further FDI in the pharmaceutical sector.

With energy demand rising in Pakistan, the greatest benefit could accrue in the sphere of energy cooperation, which could act as the single most effective confidence building measure. It could result in wider participation from stakeholders and promote market integration in energy-related trade. Several projects involving cross-border trade in coal, hydroelectric power, petroleum

products, thermal energy, renewable energy, and bilateral and regional grid interconnection have the potential to be economically viable[40]. Cross-border "power trade" could be done via bilateral power trade, pool-based exchange, or a wheeling facility. Overall, there is high potential for energy trade between the two countries, for which talks are ongoing.[41] India and Pakistan are considering the option of electricity trading. The first meeting of the Joint Group of Experts to examine the feasibility of trade in electricity was held on October 20, 2011 at New Delhi. The Central Electricity Authority and Power Grid Corporation of India Limited/ Power System Operation Corporation Ltd were designated as the nodal technical agencies from the Indian side. They are interacting with the National Transmission and Dispatch Company Ltd. of Pakistan to work out optimal technical solutions for grid connectivity between the two countries. A broad understanding has been reached on possible grid connectivity between Amritsar and Lahore to enable trade of up to 500 MW of power. As of January 2014, the Federal Cabinet in Pakistan approved the signing of a Memorandum of Understanding between the two countries.[42] Given the importance of electricity for Pakistan's domestic economy, the electricity sector can be seen as one of the most important sectors for investment.

Pakistan has been trying to make the energy sector lucrative for Indian investors by offering incentives such as customs and sales tax exemption in Special Economic Zones, zero import duty on machinery for energy plants, etc. There is a need to pass this information to Indian investors. India is one of the most rapidly growing energy markets in the world and will be able to absorb new sources of supply as they materialize in the region. Pakistan can be a potential transit route for energy from Iran and Central Asia through the construction of pipelines. This will require major capital investment. The Iran-Pakistan-India (IPI) pipeline and the Turkmenistan-Afghanistan-Pakistan-India (TAPI) pipeline are two such ambitious projects, for which

negotiations are underway. A huge transit fee and a share in gas supply on a daily basis is the direct benefit that will accrue to Pakistan in such cases.

Energy cooperation between India and Pakistan would have an overall stabilizing effect on the region, and such ventures can be explored in other areas of energy. For example, India can invest in Pakistan's power sector, on which the backbone of the economy—the textile sector—is also dependent. Pakistan experiences major power cuts that adversely affect its industries. FDI in this sector will have twin benefits. First, it will rectify power problems in the domestic economy. Second, it will contribute to attracting more MNCs to Pakistan. Further, investment in such crucial sectors can ensure better safety of investment and promote economic development in the country. For the long-term strategic benefit of the country, proposals for acquisition of overseas assets in the energy sector through PSUs or a special purpose fund are being discussed.

Textile is one sector in which Pakistan has a comparative advantage. However, the textiles sector in Pakistan is not technologically advanced. There is a case for India and Pakistan to leverage each other's comparative advantage by complementing each other. Initially, the opening of trade with India can help Pakistan acquire high-tech machinery at lower prices than the ones it currently acquires from Germany. Further, JVs can help combine the strengths of Pakistan's designs and fabric with Indian marketing skills. This sector offers scope for technology sharing. Pakistan and India are competing for the same international markets. The two countries can jointly cater to international markets, such as Europe, by producing high-quality and cost-effective textile products. In other words, instead of acting as competitors, both countries can collaborate by focusing on value addition and joint marketing for European and ASEAN countries.

Pakistan's performance on most logistics indicators, including quality of trade and transport infrastructure, is lower than for most Asian countries, particularly India.[43] The transport sector in Pakistan suffers from low quality, long travel times, and poor reliability that hinder the economic growth of the country. In this regard, India can offer logistics support to meet increased transportation requirements in Pakistan. India can invest in infrastructure projects similar to its successful home projects like the Delhi Metro. Investments in trade corridors should also be encouraged.

Tertiary Sector

India has established itself as a major player in the Information Technology (IT) segment. Although the software industry in Pakistan is still in its nascent stages, it has the potential to emerge as a major software export and training center. India and Pakistan could enter into joint ventures to tap the global market for software. While Pakistan can provide professionals at lower wages, Indian companies could help procure international contracts.[44] India has a comparative advantage in IT in terms of low-cost, qualified, English-speaking personnel. This can be replicated in Pakistan. Another area where the two countries could gain is if India sets up training institutes in Pakistan or if professionals from Pakistan are allowed to go to India to get professional training. Healthcare services are another area in which there are opportunities for both countries. Owing to relatively efficient health system, India has emerged as an important destination for provision of medical services due to affordable treatment costs and advances in medicine. Despite a relatively tight visa regime, the number of patients going from Pakistan to India has been on the rise. According to a report, the Indian High Commission in Islamabad issued 1,992 medical visas to Pakistani citizens during 2008-10. In addition, 2,917 visas were issued to medical attendants during the same period.[45] Several Pakistani patients have been

visiting India for medical treatment, such as liver and kidney transplants and open heart surgery[46] and the Mumbai Obstetric and Gynecological Society provides fertility treatment to Pakistani couples. In April 2014, Indraprastha Apollo Hospitals created a milestone by becoming the first hospital in India to reach the 500th mark for patients from a single foreign country, Pakistan. Patients from Pakistan constitute 29 percent of liver transplants performed at Apollo hospitals, New Delhi. This opens up avenues for further promoting medical tourism between India and Pakistan.

Cross-border investment in hospitals is another potential area of cooperation. Several leading Indian hospitals have entered other markets in the South Asian region through joint ventures with a local partner, wholly owned subsidiaries, or management contracts. There are also tale-medicine links between major hospitals in India and establishments in other South Asian countries, mainly for tale-consultation and tale-diagnostic services. There is no reason as to why branches or subsidiary hospitals cannot be set up in Pakistan as they have done in other South Asian neighbors.[47] For the potential investments to fructify, the two countries have to take measures in several areas. It is important to examine the regulatory regime governing investment flows between India and Pakistan, the existing barriers to investment in Pakistan, and the need for banking channels to facilitate investment flows between the two countries.

Existing Barriers in Pakistan

Despite the investor-friendly nature of the FDI policy offered by Pakistan government, investment from India has not yet entered the Pakistan market. There are tangible and intangible barriers to investing in Pakistan that are not due to the policies, but to the underlying nature of the Pakistan economy. The major barriers in the way of foreign investment are described below.

Law and Order

In recent years, the law and order situation has deteriorated all over the country. It is far from satisfactory even in the growth capital of the country, i.e., Karachi.

Lack of political stability

Political risks largely depend on political stability and governance by the government. Political stability is extremely important for the normal macroeconomic and business environment of a country. It enhances the probability of attracting FDI inflows into countries, as it builds confidence among investors. Several studies show that the degree of political stability is an important factor that investors consider when entering business and it significantly affects FDI flows. If the country's political stability is low, foreign investors hesitate to bring in projects until they are assured that the business environment is conducive and favorable.[48] Pakistan has been suffering from instability in its political system and this can be identified as the most important barrier that has prevented Pakistan from receiving large inflows of FDI from countries including India. Even the World Bank (2011) categorically states that private sector investment is low in the country because of political instability and corruption.

Since 2008, political instability in the country has increased. One measure of political instability is the *political instability index* that shows the level of threat posed to governments by social protest.

Pakistan's FDI in India: Potential and Prospects

The recent announcement by the Indian Government regarding opening up of the country's Foreign Direct Investment (FDI) regime for Pakistani investors comes at a time when India-

Pakistan trade normalization process is progressing at an encouraging pace. It is no surprise that investors from both countries have been working closely in joint ventures in third countries, but have not been able to progress in terms of bilateral investments because of political barriers. However, there were some who managed to bypass such barriers; more recently, Pakistani businessmen based and registered in places like Dubai and Malaysia have started investing in India through partnership agreements with Indian resident businessmen. Investors on both sides are ready to employ competitive advantages in their neighborhood and reap economies of scale. The examples of India's Tata group showing interest in Pakistan's energy sector and Pakistan's Mansha group showing interest in India's banking sector show that, on both sides, the business community has done its homework towards exploring its niches. Academia and development partners have long demonstrated through empirical methods how supply chain development in South Asian countries can benefit the region as a whole. Sadly, not much research exists specifically for India and Pakistan at the sectoral level. However, the recent experience of Pakistani investors in Bangladesh proves the win-win case that will be possible for India and Pakistan. Around 2008, several Pakistani textile firms opened branches in Bangladesh to reap the benefits of Least Developed Country (LDC) status, which allows Bangladesh duty free access or reduced tariffs in foreign markets, particularly the EU and US, where major market exists for Pakistan's readymade garments. During 2010 on Pakistani firms that opened branches in Bangladesh show employment creation for Bangladesh's labor force, technology transfer for Bangladesh's textile sector,

increased royalty for Pakistani investors and increased exports of raw material to Bangladesh. A similar story has been observed in the case of Pakistan's investments in Sri Lanka in sectors such as food processing and construction materials. Replicating the regional experiences for India-

Pakistan should not be difficult given the sheer size of the two economies and the opportunity presented by a large – and growing – domestic demand in both countries. While Pakistan is soon expected to reciprocate India's decision to open up FDI, several complementary reforms may also be required to ensure smooth flow of investments between the two countries. First, the home departments on both sides should ensure that the recently agreed visa liberalization policy between the two countries is implemented fully and expanded to other cities on an expedient basis. Allowing physical capital to move while human capital is curtailed does more harm to the production process, and prevents future cash flows. This happened last year when Pakistan's government drastically reduced the sensitive list and liberalized trade with India. While this allowed steel manufacturers in Pakistan to import machinery at much reduced rates from India in comparison to other parts of the world, such machinery has been lying redundant for weeks, sometimes months, because of delays in allowing visas for Indian engineers who were to come to Pakistan to install the machinery. Second, there is a need to harmonize product standards with the rest of the world. For example, in a discussion with auto part manufacturers in Pakistan it was pointed out that while they were interested in investing in this sector in India, the two industry standards followed by India – Bharat 1 and Bharat 2 – are seen in no other country in the world. Such standards act as barriers to entry for producers who can genuinely enhance consumer surplus in India. The consumer rights organizations in both countries should take note of standards that curtail trade and investment, leading to a decrease in consumer welfare. Third, a natural path in the economic integration for both countries should be to move towards a bilateral investment treaty. This will boost both the safety of investments and boost investor confidence. Under such a treaty, investment from the other country should be treated on par with domestic investors. Similarly, country-specific bias in competition policy and other sector-specific policies

needs to be removed. Such treaties allow transfer of investment-related funds into and out of a host country without any delay at the open market exchange rate. Fourth, and a point related to the above, is the need for a sovereign guarantees framework, at least in the short term. Most investors we have come across in Pakistan were fearful that future political friction between the two countries could affect their business in India. It is need to provide sovereign guarantees to investors from Pakistan that ensure full compensation if harm is caused to their investment in India (or Pakistan) due to actions related to foreign or defense policy. It is important to note that such a measure would be unnecessary if the two countries move towards a comprehensive bilateral investment treaty.[49]

Strategy for Future:

There is an urgent need for evolving an action plan on the following guide posts.

a) Keep up the continuous efforts for the grant of the MFN status by Pakistan to India as early as possible. Heavens have not fallen as a result of Pakistan not granting the status so far. Heavens would not shine on India, if it does. It is a matter of give and take. But it is a psychological weapon which India has for projecting Pakistan to the international community as an unreasonable power. Intensify the interactions with those sections of the Pakistani business community which are in favor of an early normalization of the business relations in order to step up pressure on Islamabad from its own business class. Keep the talks going on the pipeline issue without any illusions regarding its early and smooth implementation? **b)** Identify those areas of cooperation which could be projected to Pakistan as stand-alone areas. In one of his statements in India, Prime Minister of Pakistan has been quoted as referring to cooperation in the field of agriculture between Indian and Pakistani Punjab's, as another possible stand-alone area which Pakistan would be prepared to take up without linking it to the Kashmir issue? Pakistan's

agriculture has not been doing as well as that of India as India is self-sufficient, forcing Pakistan to import wheat periodically. This is an area which needs to be explored intensively and extensively. A breakthrough in this direction is the need of the day. **c)** Planner and Policy makers both in India and Pakistan, as well as influential sectors of political and economic elite are also aware of the considerable potential of Indo-Pakistan economic and technological cooperation in areas of "mutually beneficial commonalties" that have come up in the wake of business liberalization (NEP). **d)** To exploit and capitalize the potential and opportunities arising out of changed political and economic environment. Governments in both nations must demonstrate their resolve to incrementally revise of fiscal policies that have prevented the flow of human capital and knowledge exchange wherein peoples and ideas across their national borders be exchanged, as they are major constraints in the way of the needed economic and technological collaboration. **e)** Intensify the interactions with those sections of the Pakistani business community which are in favour of an early normalization of bilateral economic relations. f) Identify areas of cooperation. Pakistan's agriculture has not been doing as well as that of India. Pakistan has to import wheat periodically while India is self-sufficient in food grains. This is an area which needs to be explored intensively and extensively, for a possible co-operation as hinted by the Pakistan's Prime Minister. **g)** Governments in both the countries must demonstrate their resolve to revise official policies that have prevented the flow of human capital and knowledge exchange.

End Notes:

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