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Enhancing Indo-Pak Trade
Perspectives from India

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Bilateral trade relations between India and Pakistan have always been shaped by their political relationship. Every terrorist attack confirms that economic relations cannot exist without first resolving the security issues between the two countries. On the other hand, the peace constituency in both countries believe that better trade relations can play a very significant role in enhancing bilateral ties.

Can trade relations lead to better ties between the two countries or will better ties lead to better trade relations between the two countries?

II
INDO-PAK TRADE: PRESENT COMPOSITION

In 2006-07, Indian exports to Pakistan stood at US $ 1.35 billion, but comprised a mere 1.06% of India's exports to the rest of the world. The next year was slightly better with Indian exports to Pakistan reaching 1.1%. Exports from India to Pakistan increased by 95.63 percent to US $ 1.3 billion in 2006-07 against US $ 690 million in the previous fiscal. Imports from Pakistan in the same year were worth US $ 320 million, an 80 per cent increase over the previous year figure of US $ 180 million. On the other hand, Indian imports from Pakistan were insignificant as compared to its imports from the rest of the world- just 0.17% or US $ 0.32 billion in 2006-07, which further reduced to 0.12% in 2007-08. Compared to its imports from the rest of the world, India's imports from Pakistan are only 4% (Khan 2009).

Currently, the official trade is about US $ 2 billion per year. Pakistan accounts for less then 1 percent of India's trade and India accounts for less than 5 percent of Pakistan's trade. Estimates from gravity models suggest that trade between the two countries could be 5 to 10 times larger, and would also lead to an increase in their household incomes and GDPs in both countries. Pakistan's Commerce Secretary, Suleman Ghani recently stated that trade between India and Pakistan could go up to US $ 10 billion annually in 5-6 years, if both countries would resume their dialogue (Khan 2009).

A 2007 study by the Indian Council for Research on International Economic Relations (ICRIER), an economic think tank located in Delhi, indicates that there exists an Indian export potential of US $ 9.5 billion vis-à-vis Pakistan and a smaller import potential of US $ 2.2 billion. In other words, India and Pakistan are exploiting around 15% of each other's export potential.

Official trade between the two countries might be low but there is a covert market for unofficial trade. There is a lucrative underground market for Indian goods in Pakistan illustrating a demand for tea, sugar and other essential commodities, industrial machinery, cement, tyres and chemicals, which are smuggled into Pakistan. Similarly, edible oils, spices, dry fruits and pulses are smuggled into India from Pakistan. The trade route for this underground trade is the long border between the two countries and also through Iran and Afghanistan. There is another trade link, which is routed through third countries such as the United Arab Emirates, particularly Dubai. This circuitous route enriches middlemen and also drives prices upwards. This trade is estimated at some US $ 2 billion to US $ 3 billion per year, and this trade, if undertaken bilaterally, could be done at a much lower cost (Khan 2009). This unofficial trade, in other words, is

Indo-Pak dialogue on Conflict Resolution and Peace Building is an ongoing project of the Institute of Peace and Conflict Studies, New Delhi.

As a part of this project, the Institute is publishing a series of background papers on various Indo-Pak bilateral issues. Besides, the Institute is also organizing track-II dialogue between the two countries in October 2009. For more information about this project, kindly visit IPCS website.

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about 10 times the size of the official trade, and is symptomatic of the trade potential and reflects n the business class's anxiety to trade with each other.

II
ISSUES/PROBLEMS IN INDO-PAK TRADE

The major constraint in Indo-Pak trade is the mindset of the people on both sides of the border. A section in Pakistan feels that a softening of the border would lead to India dumping goods in Pakistan, which would hurt the local Pakistani traders. Indian analysts believe that an increase in trade would result in an increase of people to people interactions between the two countries and might even lead to the eventual resolution of the Kashmir issue, which is something that the Pakistani army is loathe to see happening. In India, the biggest concern against expanded trade relations is security. India fears that a porous border would make infiltration by undesirable elements easier, and this fear has heightened since the Mumbai attacks.

A major irritant in bilateral relations has been the continued use of a "positive list" by Pakistan in its trade with India. SAFTA expects its members to cut tariffs to between zero and five percent within seven years of the start of the agreement. All the member countries, except Pakistan, have implemented SAFTA in full, which still trades on the basis of a positive list. When SAFTA came into effect, Pakistan allowed tariff reductions on the import of 4872 products from Sri Lanka, Bangladesh, Bhutan, Nepal and Maldives. However, in the case of India, it limited these concessions to the products in the "positive list" of 773 items. In November 2008, it expanded this list to 1075 items. India also begrudges Pakistan's refusal to grant India the Most Favored Nation (MFN) status, a move that India has already granted to Pakistan.

Pakistan, on the other hand, claims that India's non-tariff barriers act as a greater obstacle to trade relations. Pakistan's trade with India is primarily in the agricultural and the textile sector and these are two areas where India has its strongest regulations. These barriers make trade more favorable for India, notwithstanding the MFN status granted to Pakistan or the positive list that it uses to trade with India. Also, Pakistan's trade policy, has been inward looking, which has discouraged imports in general, and particularly imports from India. Pakistan's economy has been growing at a very slow pace and the same applies to its industrial sector. Apart from that, it does not have the foreign currency to pay for its imports (Kamath 2005).

Another major constraint has been the high tariff and non-tariff barriers. The annual demand for tea in Pakistan is 140 million kilograms but due to the 30 percent tariff imposed on Indian tea, India's market share is a mere five million kilogram. Pakistan's annual demand for tyres is 1 million; it produces only 200,000 tyres. India is the best option to fill this deficit with affordably priced tyres; however, an import duty of 46 per cent drives the price of Indian tyres through the roof. Zinetac, a patent medicine for acidity, sells in India at Rs7.20 for 10 tablets; it retails in Pakistan for between Rs80 and Rs150 (Bhatt 2003). Similarly, India's tariff rates remain high, especially for goods of particular interest to Pakistan, such as textiles, leather, and onyx, and nontariff barriers are substantial.

Terrorist attacks or its threat also acts a constraint on Indo-Pak trade. After the Mumbai attacks, The Federation of Indian Chambers of Commerce and Industry (FICCI) conducted a survey of Indian exporters and importers doing business with Pakistan and revealed that the tumultuous situation in Pakistan had created a "fear psychosis" among Indian traders who were unwilling to travel to Pakistan to even sign closed deals. Trade between the two countries was predicted to tumble down to 900 million dollars from about 2 million dollars in the current year. Finally, both countries, also have a non-existent trade in services. Surprisingly, even though there is no restriction, there is hardly any trade in services. There are virtually no foreign direct investments (FDI) between the two countries. In both these cases, prior government approval has to be obtained and it is evident that they are only granted very sparingly (Khan 2009)

In addition, the infrastructure in both countries is inadequate or underdeveloped; there is bureaucratic inertia, excessive red tape, poor transport facilities, political opposition and visa and customs restrictions.

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III
RECOMMENDATIONS

Immediate Measures

- Ease restrictions on visas, and issue special multiple entry visas for businessmen, eliminating requirements to report arrival to the police at each place of stay, eliminating city specific visas.
- Open additional border crossings and

increase traffic frequency on the road through the Wagah border.

- Allow increased traffic through the Srinagar-Muzzafarabad route, which is currently restricted to crossing once a week.

- Start additional bus and rail routes.

- Start air ink between the two capitals-New Delhi and Islamabad. The only air links are Lahore-New Delhi, Karachi-New Delhi, and Karachi-Mumbai (Khan 2009).

- India should also work on improving customs borders (Kumar 2007). Recently, Pakistan's Ministry of Railways approved India's proposal to launch a South Asian regional train service between India, Pakistan and Bangladesh. This proposed railway could be a milestone in developing bilateral trade relations. The initial proposed route would be Dhaka-Delhi-Lahore and could be extended to Karachi or Islamabad.

- Sign a protocol to eliminate the requirement that ships touch a third country port before bringing in imports; this affects the trade of high bulk, low value goods such as cement, tar, and coal, making their transportation via sea commercially unviable (Khan 2009).

- Establish web portals. Traders on both sides should be informed about the policy environment in the country through government websites. Improving information flows between the two countries will reduce the search cost of trading (Industrial Economist 2009).

- Create awareness through more trade fairs and exhibitions. FICCI had organized "Made in Pakistan" Exhibition in March 2004, which drew more than 40000 Indian visitors each day. Similarly, FICCI would like to organize a "Made in India" Exhibition in Pakistan with the support of the Federation of Pakistan Chambers of Commerce and Industry which would be a giant leap forward in bilateral trade and result in a large number of business deals fructifying. (Modi 2008).

- Allow the private economic bodies to play an important role in increasing trade cooperation between the two countries. The India-Pakistan Chamber of Commerce and Industry, which organizes trips by business delegations and annual meetings in each country must be recognized and strengthened. The chamber has suggested multiple-entry visas without any city-wise restriction for business people whose papers have been authenticated by the official Chambers of India and Pakistan, FICCI and the Federation of Pakistan Chambers of Commerce and Industry (FPCCI). The chamber has also demanded bonded warehousing facilities at the border and seamless transshipment (Kamath 2005).

Pakistan should grant MFN status to India and continue trade on the basis of a negative list rather than a positive list. In turn, India should reduce tariffs on goods of particular interest to Pakistan

- India and Pakistan must work on improving banking facilities on the Indian and Pakistani side. Trade across the LOC border in disputed Kashmir restarted in October 2008 as a confidence building measure after a gap of nearly 60 years. After a year, business has taken off, with current trade estimates around US $ 4.87 million but this trade is mostly in the form of barter with no currencies being exchanged, in the absence of banking and modern trade facilities.

- Indian and Pakistani traders should be allowed to open branches of their banks in the other countries and also be allowed to hold accounts in the currency of the other.

- Invest in infrastructure development like wider roads, more spacious truck depots and warehouses near the Wagah border as well as reduction in the time involved in Customs and border crossings (Mehta and Mitra 2007). Customs ports where "sensitive" items can be cleared without any delays and without 100 percent verification should be increased (Khan 2009). These could increase demand and supply for imports and exports in India from Pakistan. Roads need to be expanded and upgraded, and ports should be modernized. Improving regulatory frameworks for key infrastructure sectors would provide incentives for the private sector to invest in infrastructure projects and improve them (Khan 2009).

Medium Term Measures

- Pakistan should grant MFN status to India and continue trade on the basis of a negative list rather than a positive list. In turn, India should reduce tariffs on goods of particular interest to Pakistan like agriculture and textiles-two areas where Pakistan has the biggest exports. Tariff rates are currently higher in India as compared to Pakistan.

- Invest in gas pipelines. The Iran-Pakistan-India gas pipeline project would reduce transport and communication costs.

- Obstacles to FDI flows, other than restrictions based on national security grounds, in both directions should be eased and obtaining government should be streamlined. Each country's companies should be allowed to float shares in the securities market of the other, and double taxation on corporate and individual incomes should be removed (Khan 2009)..

Long Term Measures

- At the regional level, today, the SAARC economic union seems like a distant dream. The first step would be to free trade between the SAARC countries especially India and Pakistan. Trading on the basis of a negative list would be a step in this direction. More importantly, private sector initiatives should be strengthened as they might go a longer way than official initiatives.

- Both countries should ink new trade treaties or strengthen the existing ones to ensure that enhanced trade relations do not create space for increased conflict between the two states. Trade relations between India and Pakistan will never be carried on in isolation from the political compulsions of the two countries.

- India and Pakistan have to step out of the security mindset and make efforts to increase the domestic constituency for peace in each country.

- Include private trade initiatives, students, journalists, diplomats; business communities, women's groups and so on .

A small trading step by India and Pakistan could be a giant leap for South Asia

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