Enhancing India-Pakistan Trade

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Recent moves toward normalizing trade between India and Pakistan augur well for both the economies and bilateral relations of these two historic rivals. This ongoing process has the potential to unleash massive trade opportunities for both India and Pakistan. But there is much work to be done and significant hurdles to overcome before this goal can become a reality.

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Executive Summary

The trade normalization process between India and Pakistan will undoubtedly open new trade opportunities. This study assesses trade possibilities between the two countries, examines the physical and regulatory impediments to realizing the trade potential, and suggests how the trade potential can be realized. The main findings and recommendations are summarized below.

Bilateral trade potential between the two countries is estimated to be $19.8 billion (U.S.), which is 10 times larger than the current $1.97 billion in trade.[i] Of this, export potential accounts for $16 billion and import potential accounts for $3.8 billion. The potential in mineral fuels is another $10.7 billion, of which export potential accounts for $9.4 billion and import potential $1.3 billion.

The three categories with the largest export potential from India to Pakistan are machinery, mechanical appliances and electrical equipment, and chemicals and textiles, accounting for 54 percent of total export potential. At a disaggregated level, the largest potential items include cellular phones, cotton, vehicle components, polypropylene, xylene, tea, textured yarn, synthetic fiber, and polyethylene.

The three categories with the largest import potential to India from Pakistan include textiles, jewelry and precious metals, and base metals, accounting for 45 percent. At the disaggregated level, the items with largest import potential include jewelry, medical instruments and appliances, cotton, tubes and pipes of iron and steel, polyethylene terephthalate, copper waste and scrap, structures and parts of structures, terephthalic acid and its salts, medicines, and sports equipment.

A substantial proportion of India's export potential – 58 percent – is in products that are on Pakistan's negative list for India or on Pakistan's sensitive list applicable to India under the South Asian Free Trade Area (SAFTA) agreement. Similarly, 32 percent of India's import potential from Pakistan is in items on the sensitive list for Pakistan applicable under SAFTA.[ii]

Pakistan's negative list indicates that the automobile and component industry is the largest sector that enjoys protection from Indian imports. Overall reduction in tariffs would further benefit the development of the automobile sector that India has witnessed. On the other hand,

agricultural items, in which resistance to liberalization is building up, are unlikely to have any impact as this sector has already been liberalized. Pakistan's sensitive list indicates that textiles account for 24 percent of the items on the list, but this sector accounts for only 3 percent of India's export potential of items on Pakistan's list.

India's sensitive list under SAFTA applicable to Pakistan indicates that the textiles sector is protected the most – a sector in which Pakistan enjoys a comparative advantage. Most of the items on the sensitive list are fabrics, which if allowed at preferential (lower) tariffs into India will compete with large firms (rather than small firms) in India that produce comparable quality. Even though these firms are likely to oppose liberalization, there is no rationale to protect large firms.

There are also opportunities in the services sectors such as information technology and business process outsourcing, health care, and entertainment. These services would require the movement of people to consume and provide services.

To realize the untapped trade potential between the two countries, several physical and regulatory impediments need to be addressed. The physical infrastructure at the land routes is inadequate even though new facilities have been put in place for cross-border road transportation of goods. The transport protocols between the two countries need to be amended to allow seamless transportation of containerized cargo in each other's territory without the requirement of transshipment of cargo at the land borders. A much larger increase is expected once the road-based positive list is dismantled. Opening of land borders should also be used for linking seaports in both countries. India could also link up with Central Asia through Afghanistan if it were granted transit rights. These measures could bring about a substantial reduction in transaction costs of trading between the two countries.

Non-tariff barriers have been a key issue with Pakistani business people while accessing the Indian market. While there are genuine non-tariff barriers related to the complexity of regulatory procedures, non-transparent regulations, port restrictions, and problems related to recognition of standards and valuation of goods, these are not discriminatory and are being addressed in India's ongoing reform process. It is more difficult to address "perceived" barriers that business people face in entering each other's markets. Business people fear entering these markets as they are not sure their goods will be welcomed. This is more so in the consumer goods market segment. However, there is evidence that some businesses have made a bold entry with their country labels and have not met much resistance. Exhibitions and fairs are an effective way of dealing with these perceived barriers.

Even as tariff and non-tariff barriers are lowered, informal trade is likely to co-exist with formal trade for some time. Third-country traders have played a dual role as facilitators and guarantors of trade transactions between Indian and Pakistani traders. Until business partnerships can materialize through market forces, payments can be ensured, and trust in business relationships can be established, informal trade may not shift to formal channels.

For deeper and stronger trade linkages, it is important that there are foreign investment flows between the two countries. India has now permitted outward flows of investment to Pakistan and inward flows of investment from Pakistan. If a bilateral investment treaty is put in place, it will improve business confidence to invest in the other country.

A key determinant of the realization of trade potential is the liberalization of visas. The revised visa regime provides only an incremental improvement over the existing system. The two countries should move to a more liberal visa regime without compromising on security.

Introduction

Ever since India and Pakistan emerged as sovereign nation states after independence and partition in 1947, trade between the two countries has been inextricably linked to the political relations between them -- until recently. India-Pakistan trade fell drastically in the years after 1947 and came to a standstill following the war between the two countries in 1965. There was virtually no trade between the two for almost nine years until 1974, when they signed a protocol on resumption of trade. Subsequently, trade was resumed but only on a list of mutually agreed items. In 1996, India accorded Most Favored Nation (MFN) status to Pakistan under which it offered Pakistan the same trading regime that it offered to any other country. Pakistan, on the other hand, continued to allow imports from India only for a limited number of items, collectively known as the positive list, although the number of items on the list increased gradually. The granting of MFN was linked to the resolution of the Kashmir issue. In fact, trade relations between the two countries were linked to political events for a long time and India stopped trade via the air and land routes between 2001 and 2004 following the attack on the Indian Parliament in December 2001.

Trade between India and Pakistan was restricted on several other counts – the major ones being: a restrictive maritime protocol until 2005 allowed only Indian and Pakistani vessels to carry cargo between the two countries. Further, any India bound vessel from Pakistan or Pakistan bound vessel for India could not send cargo to or bring cargo from a third country; such vessels could only operate directly between the two countries. Further still, there was only the rail route for cargo movement between the two countries; and no access to road-based trade until 2005. The restrictive trading environment resulted in large informal trade flows between the two countries, the best-documented routes being through third-country ports, mainly Dubai.

The process of trade normalization was set in motion in 2004 by talks at the commerce secretary level on commercial and economic cooperation between India and Pakistan. During this composite dialogue, trade negotiations were to be carried out parallel to a dialogue on several other issues. This marked the beginning of the delinking of trade negotiations and political issues.

In 2004 India and Pakistan, as members of the South Asian Association for Regional Cooperation (SAARC), signed the South Asian Free Trade Area (SAFTA) agreement. The members of SAFTA included four least developed countries (LDCs) – Nepal, Bhutan, the Maldives, and Bangladesh – and three non-least developed countries (NLDCs) – India, Pakistan, and Sri Lanka. SAFTA, like all other regional agreements under the World Trade Organization, required members to offer MFN treatment to one another. However, even after SAFTA was ratified in 2006, Pakistan did not accord MFN status to India and continued to trade on the positive list. The positive list was even more restrictive for road-based trade, as Pakistan allowed only 13 items on the list to be imported from India by road. Thus SAFTA has been a virtual non-starter with two largest countries in the SAARC region – India and Pakistan – not trading under MFN rules.

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Despite this, the bilateral trade dialogue that had started in 2004 continued. Four rounds of talks concluded during 2004 and 2007 and resulted in three major changes – an expansion of the positive list, opening of the road route for the first time in 2005, and an amendment of the maritime protocol. As part of the confidence-building measures, in October 2008 the two governments permitted trade and travel across the Line of Control between the two divided parts of the former state of Jammu and Kashmir.

Following the Mumbai attacks in November 2008, the composite dialogue was stalled and then 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, held in April 2011, laid down the blueprint for normalizing trade between the two countries. Perhaps what set the tone for the talks in the joint statement issued by the two countries following these talks was the recognition by both sides that it was essential for the two governments to promote bilateral trade to "build confidence, dispel misunderstandings and allay misapprehensions." While the agenda was very detailed (covering among other things the MFN issue, addressing non-tariff barriers, improving border infrastructure, customs liaison, harmonization of customs procedures, trade in electricity and petroleum products, cooperation 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 non-tariff 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. In the first stage, 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. This would also apply to the road route on which the number of permitted items had increased over the years but was still only a fraction of the items on the positive list. This process would usher in the full phasing-in of MFN and form an essential part of the trade normalization process.

Adhering to the Joint Statement, Pakistan made a transition from the positive list approach to a small negative list of 1,209 items in March 2012. However, it continued to restrict road-based trade by allowing only 137 items to be imported from India via road. Since then, trade negotiations on MFN changed stance one more time following a number of steps that India took to address non-tariff barriers.

In September 2012, negotiations shifted to India offering concessions under SAFTA in exchange for Pakistan granting MFN. During this seventh round of talks, India and Pakistan agreed to further deepen the preferential arrangements under SAFTA. This involved reducing tariffs on all items except a list of items known as the sensitive list, on which tariff concessions were not allowed in order to protect domestic markets. In a major step, India offered to prune its sensitive list and it was agreed that India would announce the reduction in sensitive list items before December 2012, after Pakistan gave notice of complete transition to MFN status for India, including the phasing out of negative lists and removal of restrictions on items traded by road. India would then bring down its SAFTA sensitive list to 100 tariff lines (from the existing 614 items) by April 2013 and Pakistan would simultaneously announce transition dates to bring down its SAFTA sensitive list to 100 tariff lines (from the existing 936 items) within the next five years. It was also agreed that before the end of 2020, except for this small number of tariff lines under respective SAFTA sensitive lists, the peak tariff rate for all other tariff lines would not be more than 5 percent.

Even if these timelines are adhered to, Pakistan is likely to ask for concessions that India is offering to Sri Lanka – the only other NLDC member in SAFTA. India allowed duty-free access to Sri Lanka in 2005 on all items except those on the sensitive list, under the Indo-Sri Lankan bilateral free trade agreement. Further, in 2008, India pruned its sensitive list from 431 items to 215 items, further liberalizing its trade with Sri Lanka. If India reduces the sensitive list to 100 items by April 2013, both Sri Lanka and Pakistan would gain. However, while Sri Lanka would enjoy duty-free access to India for all other items because of the bilateral agreement, a maximum peak tariff of 5 percent would still be applicable for Pakistan under SAFTA.

The Context of the Study

Even though positive measures have been taken in the past, the series of measures since November 2011 will lead to a quantum leap in trade between the two countries. As India and Pakistan move toward normalizing their bilateral trading regimes, there will be new trading opportunities for both countries. It is important to quantify the trade potential and identify sectors in which trade potential is the largest. As in any trade liberalization process, there are likely to be gainers and losers. The negative and sensitive lists operational in Pakistan against India's market access to Pakistan and the sensitive list maintained by India for Pakistan's access to the Indian market are indicators of sectors in which the two countries want to protect domestic industry from each other's imports. These lists also indicate the corresponding gains to exporters of both countries. The proportion of trade potential accounted for by these categories and industry sectors would indicate the extent to which possible losers and gainers in different industries are being affected. Important lessons in different sectors can be learnt from each other's experiences in reforms.

While trade negotiations have focused largely on the goods sector, there are trade possibilities in the services sector as well. Assessing these possibilities would help to equip business people in both countries with relevant information on services trade.

The extent to which the trade potential can be realized between the two countries depends on a host of factors. Cross-border transportation at low cost can provide large gains to traders on both sides. Identifying impediments can help policymakers to take relevant measures. Non-tariff barriers are another area that requires identification of barriers to improve market access for both countries. It is also important to assess the likely impact of the trade normalization process on informal trade flows, as the shift to formal channels will determine the extent to which potential trade can be realized. Foreign direct investment flows between the two countries were not permitted for many years. Such investments can help in deepening trade linkages and sustaining trade gains. Free movement of people is an essential requirement for normal trade relations. India and Pakistan have for many years followed a very restrictive visa regime. It is important to understand the nature of these restrictions, assess the steps taken so far, and suggest further improvements. More importantly, greater people-to-people contact will remove misconceptions and help in engaging fearlessly with each other. The success of the trade normalization process will also be determined by the role of institutions that are involved in this process. These institutions include different government departments at the state center, and border level, business and trade associations, non-governmental organizations, and the media.

Against this backdrop, this study focuses on the following key questions:

1) What is the trade potential between the two countries?
    a) What is the total bilateral trade potential and which items have the largest potential?
    b) What is the potential of items on negative and sensitive lists and which sectors have the largest trade potential in these categories?
    c) What are the trade possibilities in the services sector?
2) How can trade potential between the two countries be realized?
    a) What are the transport and transit impediments and how can they be reduced to lower transaction costs of trading?
    b) What are the non-tariff barriers and how can these be addressed?
    c) What is the magnitude of informal trade and how can it be shifted to formal channels?
    d) What are the impediments related to visas?
    e) How can investment flows deepen trade linkages?
    f) What is the role of institutions in enhancing trade?

Methodology

The study uses "mixed methods." It is based on secondary sources and primary information collected through field surveys. Secondary sources include published papers, government data and policies, agreements, regulations, and protocols. Secondary data on India's trade with Pakistan has been collected from the Indian Directorate General of Foreign Trade, Ministry of Commerce and the United Nations International Trade Centre's (UN ITC) World Integrated Trade Solution (WITS) database published by the World Bank. The data are used to examine trade trends and assess trade potential between India and Pakistan. Potential trade for any commodity is given by the minimum of the supplier's global exports and receiver's global imports minus the existing trade between the supplier and receiver. The exercise is conducted by first using India as a supplier and then using Pakistan as a supplier. Primary surveys were conducted at different points in time during 2005-08 and in 2012 in India, Pakistan, and Dubai. Face-to-face interviews, focus group discussions, and stakeholder consultations were held formally and informally using semi-structured open-ended questionnaires. Interviews, discussions, and consultations were held with importers, exporters, manufacturer-exporters, freight forwarders, clearing agents, government officials at the state and center levels, and academics on various issues raised in the study, particularly those likely to affect the realization of trade between the two countries.

Trade Potential and Possibilities

The following section examines current trade trends, assesses trade potential for the two countries, examines the composition of the negative and sensitive lists, and assesses the extent of potential trade accounted for by these items. The protected sectors that have the highest trade potential are identified and the implications of opening up these sectors are discussed. Important service sectors in which trade potential exists are identified and trade possibilities in these are examined.

Trends in Trade

Bilateral trade between India and Pakistan increased by more than nine times between 2000 and 2011.[iii] Total trade between the two countries was $1.97 billion (U.S.) in 2011, of which India's exports to Pakistan were $1.66 billion and imports were $313 million (See Table 1 and Table 4A). Despite the positive list maintained by Pakistan, India has always had a trade surplus with Pakistan. India's trade balance as a proportion of its total trade with Pakistan increased from 55 percent to 68 percent between 2000 and 2011 (See Table 1).

Table 1: India's Trade with Pakistan ($million U.S.)

	2000	2011
Exports (X)	162	1,659
Imports (M)	47	313
Trade Balance (X-M)	115	1,346
Total trade (X+M)	209	1,972
Trade balance ratio (X-M/X+M)x100	55%	68%

Source: UN ITC-WITS database
Note: Excluding mineral fuels

In 2011, India's top three exports to Pakistan at the HS-21 classification of items were chemicals, textiles, and vegetable products, accounting for 69 percent of total exports to Pakistan.[iv] India's top three imports were vegetable products, mineral products, and textiles, accounting for 54 percent of total imports from Pakistan (Table A1).

At a disaggregated level (HS-6 classification), top commodities exported from India to Pakistan that year included cotton, xylene, soya-bean waste, tomatoes, sugar, chickpeas, polypropylene, tea, iron and steel containers, and organic chemicals.[v] Cotton alone accounted for 16 percent of exports (Table A2). Dates were the most important item being imported from Pakistan, accounting for 22 percent of total imports in 2011. Other items included cement, gold, lead, copper, cotton yarn, disodium carbonate, gypsum, terephthalic salts, and vinyl chloride (Table A3).

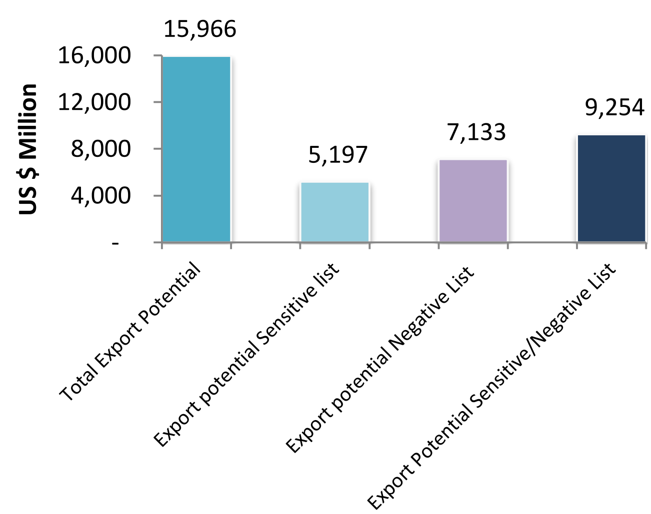
Trade Potential in Goods

Several estimates have been made to predict the likely trade potential between India and Pakistan. The most popular econometric method is the use of gravity models, which in their most basic form explain bilateral trade as being directly related to the product of GNP of the trading partners and inversely related to the distance between them. Various gravity model estimates range between 0.5 times and 27 times actual trade.[vi] While these estimates are useful, the model has some weaknesses. In the context of India-Pakistan trade, the model form has shortcomings particularly in the case of geographically contiguous countries (e.g. India and Pakistan) where despite lower distances between them transport and other transaction costs of trading are very high. Also, since existing bilateral trade has been limited due to the positive list approach, any econometric model would be limited in its use for this purpose. A simple, yet intuitive method yields more realistic results. Trade possibilities exist in items that the two countries can import from each other instead of from elsewhere in the world. In order to identify these items and assess the magnitude of trade possibilities (referred to as trade potential) between the two countries, products having trade potential were identified as those with adequate demand in the receiving country and adequate supply capabilities in the source country. The exercise was conducted by posing India as a supplier to assess its possibilities with Pakistan, and then by posing Pakistan as the supplier country. Potential trade for any commodity is given by Min (SE, MI) - ET where SE, MI, and ET are supplier's global exports, receiver's global imports, and existing trade between the supplier and the receiver.

The results of the exercise show an estimated bilateral trade potential of $19.8 billion in 2011, which is 10 times larger than the current $1.97 billion trade level. Of this, export potential accounted for $16 billion and import potential for $3.8 billion (Table A4a). The potential in mineral fuels is another $10.7 billion, of which export potential accounted for $9.4 billion and import potential for $1.3 billion (Table A4a).

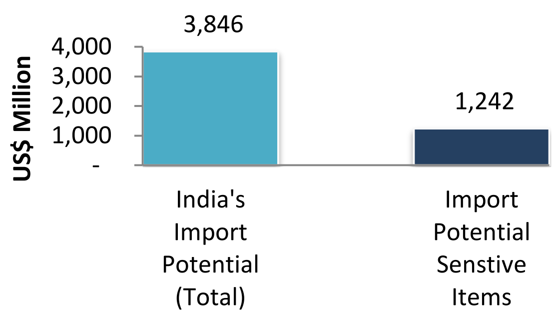
The export and import potential for Pakistan's negative and sensitive lists and for India's sensitive list is also calculated. India's export potential for Pakistan's negative list items accounts for 45 percent of its total export potential. India's export potential for items on Pakistan's sensitive list under SAFTA accounts for 33 percent of India's total export potential (Table A4b). Export potential of items that are either on Pakistan's negative list or on the SAFTA sensitive list account for 58 percent (Table A4b). India's import potential from Pakistan of items on the SAFTA sensitive list accounts for 32 percent (Table A4c)[vii]. 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 that it has on the sensitive list for NLDCs under SAFTA. Thus, even if trade is normalized, the two countries are likely to have limited preferential access to each other's markets.

Graph 1: India's Export Potential to Pakistan



Based on calculations using UN ITC-WITS database

Graph 2: India's Import Potential from Pakistan



Based on calculations using UN ITC-WITS database

These estimates have to be treated with caution and are merely indicative of trade possibilities. The estimate of trade potential is the maximum possible trade that the two countries could have if they sourced from each other all items they source from the rest of the world. This can never be the case, as relative prices would play an important role. However, this exercise gives ballpark figures on trade possibilities at a disaggregated level, particularly for items on the negative list as no trade data exist for these items. These estimates also vary depending on the year of reference. In this exercise, the calculations are based on trade data for 2011.

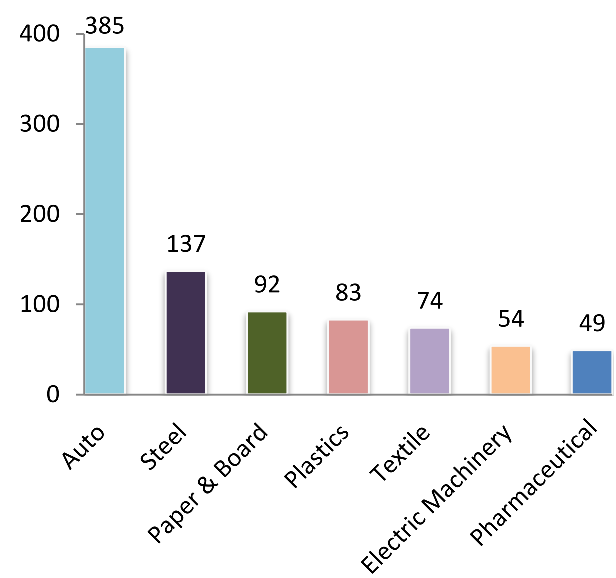
The three categories (HS-21 sectors) with the largest export potential from India to Pakistan are machinery, mechanical appliances and electrical equipment, and chemicals and textiles, accounting for 54 percent of total export potential (Table A5, Columns 3 and 4). At a disaggregated level, the largest potential items include cellular phones, cotton, vehicle components, polypropylene, xylene, tea, textured yarn, synthetic fiber, and polyethylene (Table A6). The three categories with the largest import potential are textiles, jewelry and precious metals, and base metals, accounting for 45 percent (Table A7, Columns 3 and 4). At the disaggregated level, the items with largest import potential include jewelry, medical instruments and appliances, cotton, tubes and pipes of iron and steel, polyethylene terephthalate, copper waste and scrap, structures and parts of structures, terephthalic acid and its salts, medicine, and sports equipment (Table A8).

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 $7.7 billion and the latter $1.3 billion. India's import potential from Pakistan in petroleum oils is $1.3 billion. Although both countries have an export potential in petroleum, analysis at a more disaggregated level (the eight-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 1,209 items is specified at the eight-digit level of classification followed by Pakistan Customs.[viii] This classification differs from the Indian classification at the same level of disaggregation. Analysis of the 1,209 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 (Graph 3 and Table A9).

Graph 3: Number of Commodities on Pakistan's Negative List



(Based on Pakistan Customs Classification-Eight Digit)
Source: Ministry of Commerce, Government of Pakistan

In order to assess the potential in these items, the codes had to be collapsed to the HS-6 level and further to the 21 sector level. Classified in this manner, 49 percent of the items in the negative list are accounted for by three categories: machinery, mechanical appliances, etc.; base metals and articles; and vehicles and associated transport equipment (Table A10, Column 2). A large part of these three categories consists of auto components. These sectors account for 69 percent of potential exports of items on the negative list and 45 percent of India's export potential (Table A5, Column 6). Even though farmers in Pakistan are raising concerns over unfair competition from imports of Indian agricultural products, which enjoy various subsidies, the negative list has very few agriculture items – cigarettes, tobacco, and edible oils among them. India's export potential in these items is only 1 percent of its import potential of items on the negative list (Table A5, Column 6). 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, they would not be able to compete with Indian products. [ix]

Pakistan's sensitive list under SAFTA has the largest number of items in the textile sector, accounting for 24 percent of the total items on the list (Table A10, Column 4). But these account for only 3 percent of India's export potential for items on this list (Table A5, Column 8).

India's sensitive list under SAFTA also has the largest number of items in the textiles sector, accounting for 30 percent of the total items on the list (Table A11). These items account for 38 percent of India's import potential for items on the sensitive list and 22 percent of India's overall import potential (Table A7, Column 6).

It can be inferred that while Pakistan considers its automobile sector as the most vulnerable, India fears competition in the textile sector.

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 (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 that mandated a localization of components over time to protect the local vendor industry.[x] In order to comply with WTO requirements, the deletions 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 are available from India. Opening of trade with India would make cheaper imports available to the industry[xi]. India's automobile vendor industry had a similar protected regime, including an equivalent of the deletion program for the automobile manufacturers. With continuous liberalization, India has become a global research and development and small-car manufacturing hub.[xii] Indian auto component manufacturers, meanwhile, are moving up the value chain and delivering complex products, though largely for the domestic market.[xiii] Pakistan can learn from India's experience of opening up the automobile and auto component industry.

On the other hand, India's textile and clothing sector has been one of the country's most protected sectors. Until 2005, ready-made garments were reserved for the exclusive manufacture by small-scale firms; large firms were not permitted to produce these items. To protect the domestic industry, textiles and ready-made garments were also subjected to high import duties and specific duties that were applied in quantitative terms and not on the basis of value. In some products in which there were no specific duties, ad valorem (value-based) rates exceeded 300 percent.[xiv] In 2005, ready-made 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 though the rationale for protecting the industry was no longer there.[xv] It was only in 2008 that

India removed 164 textile items from the sensitive list for LDCs under SAFTA and offered duty-free access. Similarly, in 2008, Sri Lanka was offered duty-free access for 215 textile items under the India-Sri Lanka Free Trade Agreement. In 2011, all textile items were allowed duty-free access from LDCs. Meanwhile, spinning firms were subject to mandatory obligations to ensure low-cost supply of specialized yarn for small handloom and power-loom firms.

These arrangements 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. [xvi] In 2011-12, the mill sector accounted for only 5 percent of the total cloth produced by the mill sector and the power loom sector.[xvii] 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 from the power looms is of low quality and commands a lower price.[xviii] Pakistan has a strong yarn and fabric manufacturing industry, and India's fear is that imports from Pakistan would hurt the small and medium-scale sector. Fabric imports from Pakistan, however, are more likely to compete with the mill sector in India than the power loom sector; there is thus no justification for India to protect the large firms from imports.

Trade Possibilities in Services

There are additional trade possibilities in services. The services sector is becoming increasingly important in the economies of the two countries. In 2011-12, this sector accounted for 59 percent of India's GDP and 54 percent of Pakistan's GDP. Areas 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 $87.6 billion in 2011-12. Software exports in 2011-12 were $69 billion, compared to $59 billion in 2010-11. Exports dominate the industry and constitute about 78.4 percent of total industry revenue. Indian IT service firms have evolved from application development and maintenance providers to emerge as full-service players, offering testing and infrastructure services, consulting, and system integration.[xix] 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. IT exports in 2011 were $440 million, up from $432 million the previous year.[xx] This is one of the potential areas that could be exploited. India and Pakistan could establish joint ventures in which Pakistan provides professionals at lower wages while Indian companies help procure international contracts.[xxi] Pakistan is emerging as an exporter of specialized software services such as gaming and animation, financial services, and health care; Indian companies could import these from Pakistan.[xxii]

Another area where the two countries could gain is in training. India could set up training institutes in Pakistan or professionals from Pakistan could come to India for 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 until 2016.[xxiii] India could collaborate with BPO firms in Pakistan to offer more value-added services in this segment.

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 such cooperation.

Health care services are another area with opportunities for both countries. India has become an important destination for the provision of medical services, due to affordable treatment and advancements in medicine. Several Pakistani patients have visited India for sophisticated medical procedures like liver and kidney transplants and open heart surgery.[xxiv] Other specialty services are also being offered to Pakistani patients. For instance, the Mumbai Obstetric and Gynecological Society is providing infertility treatment to Pakistani couples.[xxv] Despite a relatively tight visa regime, the number of patients going 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 opportunity 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 such cooperation.[xxvi]

There are trade possibilities in the entertainment industry as well. India and Pakistan share a common culture; hence there is opportunity for trade and cooperation in the film industry. India is the world's second largest producer of movies, while Pakistan produces very few. Pakistan imposed a ban on screening Indian films in 1965 following the Indo-Pak war.[xxvii] The purpose was to protect the domestic film industry, but the industry did not do well despite the ban.[xxviii] Since the ban was lifted in 2008, there has been uncertainty in the policy as 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 or cable broadcasts of Indian films.[xxix]

There is also interest in India and Pakistan for each other's music recordings and music videos. Similarly, some Pakistanis like to watch Indian television serials and Indians like to watch Pakistani programs. However, Pakistani entertainment channels are not broadcast in India, whereas several Indian channels are broadcast in Pakistan.

The trade potential in the entertainment industry, particularly in films, music, and television, can be tapped by encouraging joint productions. Removing movie bans would benefit both countries. Exchanging broadcasting rights to each other's television programs is another opportunity to expand trade between the two countries.

Realizing Trade Potential

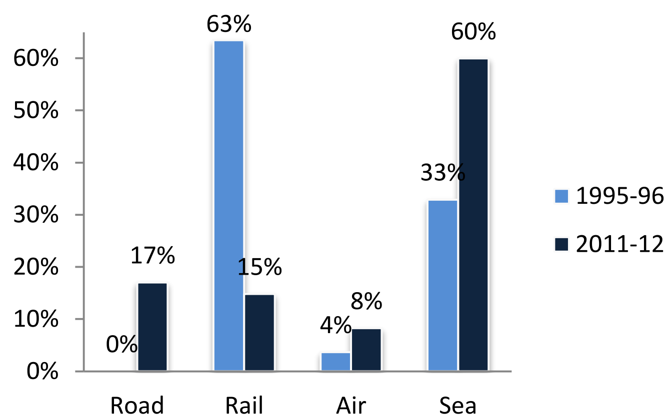
For potential trade to be realized, the two countries will have to take measures in number of areas. It is important to examine the regulatory regimes related to transport, non-tariff barriers, and visas, and assess how these regimes operate in practice. The effectiveness of these policies will also determine the extent to which informal trade flows will be redirected to formal channels. The policies related to liberalization of foreign direct investment also need to be examined, as realization of cross-border investment will lead to deeper trade linkages. It is also important to assess the visa regime and how it is likely to be liberalized, because trade realization will also depend on the extent to which visa restrictions are eased. The role of institutions in supporting the trade liberalization process also needs to be assessed, as they have a key role in helping the two countries realize their untapped trade potential.

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 is the only route that has always been operational, it has gone largely unnoticed that, until fairly recently, sea trade between the two countries took place under a very restrictive bilateral protocol. This protocol allowed only Indian- and Pakistani-flagged ships to carry cargo between the two countries. This arrangement restricted competition from foreign vessels, and therefore resulted in high rates for sea freight carried 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, a considerable reduction in costs for sea-based trade between Mumbai and Karachi.

It is not surprising that in 1995-96, a period when the road route was closed, trade by rail accounted for 63 percent of total trade, while that by sea accounted for 33 percent. By 2011-12, the share of different modes in total trade between the two countries had changed substantially due to the opening of the road route and the liberalization of the sea trade. The share of rail fell to 15 percent, while trade by sea increased to 60 percent. Share of trade by road increased from nil in 1995-96 to 17 percent in 2011-12.

Graph 4: India's Trade with Pakistan, by Mode



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

The opening of the road route between India and Pakistan in 2005 after 58 years was a historic move. India and Pakistan share a 2,912 kilometer-long border. The significance of this move can be better understood when compared to the cross-border transport protocols that India has with Nepal, which are the most liberal, allowing trucks from the two countries to move in each other's territory. In practice, however, goods from trucks from one country are offloaded at the border and reloaded onto a truck from the other country. This is because when trucks move from one country to the other, the local mafia extorts money from foreign truckers. Transshipment continues because these informal payments are higher than the cost of transshipment; weak border institutions have left the implementation of policies ineffective. The opening of the road route between India and Pakistan, however, 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 might have resisted the change. This raises immense hopes for successful implementation of further trade- facilitating measures at the land border.

Amritsar and Lahore are the two major cities on either side of the border at Attari-Wagah, separated by a distance of only 54 kilometers. The transport costs for goods moved by road between northern India and northern Pakistan can be substantially lower than using the sea route. Recognizing the importance of the land route, India opened an Integrated Check Post (ICP) at Attari in April 2012, with new features including a gate exclusively for trade, warehousing facilities, improved road infrastructure, and facilities to house all trade activities under one unit. Trading times were increased to 12 hours each day of the week. While the ICP facility is operational, two important features underway are systems for automated filing of customs documents through an Electronic Data Interchange and the installation of truck scanners. This is a marked change from the past, when there was only one gate for trade and passengers, trade times were limited to seven hours daily, and no warehousing facilities were offered.[xxx]

In a span of just six months, from April to October 2012, the warehouse reached full capacity.[xxxi] This in turn has limited the entry of trucks from across the border. The question is how these facilities will be able to bear the additional cargo load likely to occur for two reasons: Pakistan's move to normalize trade on the road route by allowing imports of all items instead of the existing list of only 137 items, and a likely shift in trade from the sea route to the road route due to lower transaction costs. The ICP, when conceived by the Indian government in January 2008, clearly did not envisage such a paradigm shift in trade between the two countries. Trade by the land route would increase further if the two governments agreed to the movement of containerized cargo by road. Allowing these trucks to travel in each other's territory would reduce transaction costs further. The two governments are also considering opening new road routes. The option of opening the Munabao-Khokhrapar road route was discussed in the seventh round of trade talks between the two governments.

The rail route was the dominant surface transport mode for India-Pakistan trade for many years. The rail route's importance relative to the sea and road routes has declined, and it continues to be limited in its reach. Products move either by the goods train often referred to as "interchange train" or by freight cars attached to the Samjhauta Express – the passenger train that runs on a twice-weekly basis, carrying six to 10 freight cars. 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 restrictions on the type of freight cars are some of the problems that traders faced.[xxxii] Also, traders in Kolkata, located in eastern India, find it difficult to trade by rail through the Attari-Wagah land border because they lack access to necessary information. Therefore, these consignments are sent by sea to Colombo, Sri Lanka, and then to Karachi. [xxxiii]

Since 2007, interchange train services have deteriorated. Goods carried by the interchange train move only between Amritsar and Lahore through the Attari rail station. Only Pakistani freight cars are currently plying this route, unlike earlier, when Indian cars were also in use. Export cargo comes in Indian rail cars to Amritsar, where it is unloaded and then loaded onto Pakistani freight cars, or it is loaded onto trucks to be sent through Wagah. Transferring cargo from Indian to Pakistani rail cars or onto trucks adds considerably to the time and cost of 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 seventh round of trade talks agreed on increasing the number of interchanges to three or four a day and allowing the use of high-capacity rail cars, the discussions so far have addressed only the immediate needs of facilitating rail transport.

The ongoing bilateral dialogue has so far not addressed the issue of transit to other countries. India has not allowed Pakistan to access Nepal, Bangladesh, or Bhutan through its territory. Similarly, Pakistan has not given any transit rights to India to access the Afghan market 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 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 Indian 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 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 developing into a logistics hub and offering a range of services to help move goods between South Asia and Central Asia. It follows that India should allow transit to Pakistani goods for the Nepali and Bangladeshi markets.

There is need to develop a long-term vision and plan for road and rail cargo movement. Limiting 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, its cargo trucks or rail cars heading back from the border may be empty or only partially loaded, adding considerably to costs. However, if they were allowed cross-border movement and if multimodal transportation permitted, cargo balancing could be achieved by linking the seaports of Mumbai and Karachi through the land route, as the seaports would link to the rest of the world.[xxxiv] Similarly, transit through Pakistan can link Indian seaports with Afghanistan and the rest of Central Asia.

Non-Tariff Barriers

For many years, the Pakistani government has expressed the position that Pakistani business people face non-tariff barriers in accessing the Indian market.[xxxv] On this issue, both countries recognized that there were no Pakistan-specific barriers, but that there was a general lack of awareness among Pakistani business people about the regulatory regimes in India. In a study conducted in 2008 for a task force on non-tariff measures (NTMs), it was found that while these NTMs were not discriminatory, the procedures related to product standards were cumbersome, some regulations lacked transparency, and there were problems related to recognition of standards. The two governments, however, recognized that even if barriers were "perceived," they needed to be addressed. To increase awareness, the Indian government arranged interactive sessions between Indian regulators and Pakistani business people in Delhi in September 2011 and in Pakistan in January 2012. This government-to-business interaction is an innovative yet simple method of addressing information gaps in the regulatory environment. In another recent effort, the Trade Development Authority of Pakistan supported experts to undertake a study that identified potential products for export to India as well as tariff and non-tariff barriers that Pakistani businesses face. The findings were disseminated to businesses in 10 cities across Pakistan to sensitize them about India's regulatory regimes. Some of the barriers identified were overvaluation of goods, tedious packaging and labeling requirements, access to a 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 WTO-compliant trade defense instruments and how they could be used to manage imports that hurt domestic industry. This government-supported awareness initiative, if sustained for a few years, could have a long-term impact in dispelling notions of perceived barriers to the Indian market, removing misconceptions, raising awareness on genuine non-tariff barriers, and equipping businesses to deal with expanded imports if they hurt domestic industry.

In another initiative to address non-tariff barriers, the two governments signed three agreements in September 2012. These were a customs cooperation agreement to help avoid the arbitrary stoppage of goods at each other's ports, a bilateral cooperation agreement on mutual recognition between the Pakistan Standards and Quality Control Authority (PSQCA) and the Bureau of Indian Standards (BIS), and an agreement on redressal of trade grievances.

Non-tariff barriers of a different nature have been identified in some studies.[xxxvi] For example, it was found that Pakistani consignments were subjected to excessive checks – usually due to security concerns, causing harassment of genuine traders. A more recent study pointed out that Pakistani businesses find it difficult to sell their goods because of an "image issue." Pakistani bed linen, for instance, is being sold in India under European and Indian labels even though these goods were not manufactured in these places.[xxxvii] Clearly, this can be addressed if efforts such as the Pakistan Mega Lifestyle Exhibition held in New Delhi in April 2012 and the Made in Pakistan Expo held in August 2012 in Mumbai are pursued more frequently. In September 2012, the Pakistan Fashion Design Council, which brings together more than 60 leading designers from all over Pakistan, opened an outlet in an up-market shopping complex in New Delhi. Such steps will no doubt raise awareness among Indian consumers about Pakistani products.

Indian businesses also face an image problem in accessing the Pakistani market. There are persistent fears in the minds of Indian business people as their business partners in Pakistan advise them not to use the "Made in India" label.[xxxviii] However, some new products, such as sweets and snacks by a large Indian manufacturer, have successfully entered the Pakistani market under the Indian label.[xxxix]

Addressing non-tariff barriers is not a one-time effort. As new non-tariff barriers are raised, they will need to be addressed. Hence the two countries will have to identify and deal with these barriers on a continuing basis.

Informal Trade

The restrictive trade environment between India and Pakistan has led to large informal trade flows between them. Estimates provided at various points in time range from $250 million to $3 billion. The most detailed study on informal trade estimated its value at around $545 million as of 2005.[xl] Of this, Pakistani imports from India were around $535 million and exports to India $10.4 million. The main import items from India, in order of priority, were cloth, tires, pharmaceuticals, textile machinery, cosmetics, livestock, and medicines, accounting for roughly 80 percent of total informal import value. Pakistan's informal exports consisted mainly of textiles, accounting for approximately 90 percent of the total trade. The modalities of Indo-Pak informal trade are the most interesting. The most well-documented route is Mumbai-Dubai-Karachi, more commonly termed as third-country trade. Khan estimated this to be around 88 percent of total informal trade and the remaining to be through the Amritsar-Lahore and Sindh-Rajasthan cross-border routes. It is not well known that about half of the informal trade taking place through Dubai at this time did not go to Karachi. Goods were moved officially from India to Dubai, shipped from there to Bandar Abbas (in Iran), and then moved via land route across Afghanistan into Pakistan. Only about 18 percent of informal trade took place by the sea route from India to Karachi via Dubai.

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

The move toward trade normalization and a reduction in tariffs and non-tariff barriers would certainly imply a reduction in informal trade flows. But such trade is likely to co-exist for some time with formal trade. Traders in Dubai have been facilitating trade between India and Pakistan for several decades. Buyers and sellers in India and Pakistan often do not know each other. Sometimes the trading partners knew each other but could not trade directly because their products were not on the positive list.[xlii] Trade through Dubai is likely to co-exist with formal trade, even if the negative list is abandoned, until such time that buyers and sellers are able to establish direct contact and mutual trust. Trade through Dubai would decline if there were active channels of information flow that would bring buyers and suppliers together to trade directly rather than through third parties.

Visas

One major pending issue is related to visa restrictions. Some of the restrictions that have limited market access for aspiring traders are city-specific visas, the requirement that traders report to police upon arrival and before departure, the need to exit from the port of entry, and delays in obtaining visas.[xliii]

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

A new visa agreement was signed between the two countries in September 2012. The agreement introduces measures to ease travel by tourists, pilgrims, the elderly, and children to facilitate contacts between people of the two countries. The business visa regime is also more liberal, as it allows one-year, multiple-entry visas for up to 10 places with an exemption from police reporting for business people who have a turnover of at least 30 million Pakistani rupees or the equivalent. For those whose turnover is 3 million rupees or the equivalent, a one-year visa for five places and up to four entries is permitted.

The new visa regime is an incremental step, but it could provide a channel for information exchange on trade-related matters between the two countries. As a next step, the countries could consider the use of information technology driven systems that would help assure adequate and effective security while allowing genuine traders to trade across borders.

Foreign Direct Investment

Investment flows play an important role in deepening trade linkages. Not only do they build stronger stakes for businesses, but they provide market access to the global, market, domestic market of the host country, and home country market[xliv]. For many years India did not permit foreign direct investment (FDI) inflows from Pakistan. In a further move to normalize economic ties between the two countries, India's Department of Industrial Policy and Promotion (DIPP) announced changes in August 2012 in the Consolidated FDI Policy to allow investment from Pakistani firms and individuals in all sectors except defense, space, and atomic energy through the government route. Following this, India removed Pakistan from the negative list under the Foreign Exchange Management Act (FEMA), paving the way for investment from Pakistan. Also, the FEMA regulations have been amended to allow Indians to invest in Pakistan. Pakistan's outward FDI flow was only $62 million in 2011. While a breakdown by country of FDI outflows from Pakistan is not available, data from the Board of Investment in Bangladesh indicate that Pakistan has invested in textile firms there. Pakistan has also invested in Sri Lanka in the food processing and construction sectors.[xlv] In the Indian context, textiles and cement are possible sectors for investment.[xlvi] A natural next step would be to move toward a bilateral investment treaty that would boost both the safety of investments and investor confidence.[xlvii] For investments to bear fruit, intermediate steps will be needed, as business interest may not be forthcoming immediately. An interesting suggestion by business people is to establish joint ventures between the two countries without locating in each other's country. Ventures set up initially in this manner could pave the way for future investor confidence.

Institutions Engaged in Trade Normalization

Trade normalization efforts have been driven at multiple levels. On the Indian side, all bilateral talks are spearheaded by the Ministry of External Affairs. Though the ministry has an overall mandate, trade is becoming an increasingly important function. Two other important government departments 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. Two key functions in the context of trade are issuance of visas and border management. As part of the border management function, a Land Ports Authority of India (LPAI) was set up in April 2012 under the Ministry of Home Affairs to provide cohesive management of cross-border movement of people and goods. This signifies the ministry's involvement in the trade normalization process.

On the visa front, the Ministry of Home Affairs and its Pakistani counterpart have moved forward. While the Indian military does not play an active role in the trade normalization process (as the Pakistani military does in Pakistan), it is not seen as an adversary of the process. 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 business communities in both countries have for several years been actively engaged in pursuing the trade liberalization agenda through their chambers of commerce. In India, the Federation of Indian Chambers of Commerce and Industry (FICCI), the Confederation of Indian Industry (CII), the Associated Chambers of Commerce and Industry (ASSOCHAM), and the Punjab, Haryana, and Delhi Chamber of Commerce and Industry (PHDCCI) have taken the initiative with cross-border delegations to interact with the Pakistani business community and assess trade possibilities. This momentum is expected to continue, as the exchange of delegations in just the past year reflected an increase of many-fold since the initiation of the trade normalization process.

The involvement of non-governmental organizations in the trade process is quite limited. Academia in India has largely focused on the political issues between the two countries. The academic discourse on the economic implications of trade normalization, or on the challenges this process is likely to face, is again very limited. Until recently, the print and visual media in India and Pakistan were engaged largely in "negative" reporting, as there was a tendency to focus on conflict rather than any peace initiatives taken by the establishment. Even the granting of MFN did not draw prominent headlines in any of the major news dailies in India even though it did so in Pakistan. There is now, however, an evident shift toward positive reporting in the media on peace initiatives and trade cooperation in both countries. This can have a huge impact on the perceptions of civil society.

Conclusion

The trade normalization process will unleash trade opportunities for both India and Pakistan. Even though the automobile sector in Pakistan and the textile sector in India are resisting trade liberalization, there is no rationale for holding back the liberalization process.

India and Pakistan need to work together in several areas to be able to realize their untapped trade potential. So far only incremental steps are being considered by the two governments to improve cross-border movement of goods. A comprehensive and integrated international land transport policy needs to be put in place, not only to provide rail and road services to connect the two countries but also to service other countries by linking seaports through land borders.

India should continue to lower its non-tariff barriers as part of its ongoing reform process. A more concerted effort is needed to help business people overcome their apprehensions about entering each other's markets. Businesses from both countries should be able to sell their products with country labels in each other's markets without fear. The unprecedented number of exhibitions and fairs held in the two countries to display products from the other country has generated an overwhelmingly positive response from consumers; such efforts should continue.

While the removal of restrictions on foreign direct investment flows between India and Pakistan has opened up new opportunities, business people from both countries are reluctant to invest as they fear the political consequences of a possible disruptive event (such as a terrorist attack similar to the 2008 Mumbai attacks). Investors also fear that they could be easy targets for those who oppose their presence. Business people in both countries are discussing the idea of having joint ventures without joint ownership of manufacturing facilities located in the respective countries. Investors could enter into such ventures without physically locating in each other's territory as the first step to entry until there are legal systems to safeguard investments and an improvement in investor confidence. This would also give societies in the two countries time to adjust to the changing scenario.

For a liberal visa regime to be put in place, smart systems can be used to screen visa applications and physical movement of people. Any other method could cause undue harassment of genuine traders. Telecommunications channels need to be opened up to foster people-to-people contact and reduce business costs. The existing communication system between the two countries does not permit travelers to use their mobile phones when in the other country. Buying local SIM (Subscriber Identity Module) cards is not an easy option, as it involves a lot of paperwork. As a result, visitors and business people have developed informal mechanisms of procuring local SIM cards through friends and relatives. The issue of improving telecommunications between the two countries was raised in the seventh round of economic cooperation talks and is expected to be part of the trade normalization process.

India and Pakistan need to engage with each other to understand each other's regulatory regimes. As new business people enter trading, it is important to have forums that bring buyers and sellers together. Banking channels that guarantee payments are essential to building new business partnerships. An innovative dispute resolution system is needed, as a conventional one may not work in circumstances where emotions run high. There is an important lesson to learn from informal trade through Dubai, which as a third country provides neutral ground for Indian and Pakistani business people not only as a facilitator but also as a guarantor of payments. Thus a third country in which India and Pakistan have mutual trust could provide an effective dispute resolution system. It is important for the business communities in both countries to create multilevel channels of communication that can reduce misconceptions, bridge information gaps, and generate a significant change in the business environment. This will be key in helping India and Pakistan realize their untapped trade potential.

Table A1: India's Exports to and Imports from Pakistan (2011)

Sector	Product Description	Exports (US$ Million)	Share of Sector in Exports (%)	Imports (US$ Million)	Share of Sector in Imports (%)
1	Live animals and animal products	15.9	1.0	1.3	0.4
2	Vegetable products	330.5	19.9	82.1	26.2
3	Animal or vegetable oils and fats	0.6	0.0	2.2	0.7
4	Prepared foodstuffs, beverage, and tobacco products	213.8	12.9	2.1	0.7
5	Mineral products	3.7	0.2	46.5	14.8
6	Chemical and allied products	419.3	25.3	30.1	9.6
7	Plastics and rubber	140.1	8.4	12.2	3.9
8	Raw hides and skins and leather products	0.5	0.0	10.3	3.3
9	Wood and wood products	0.2	0.0	0.5	0.1
10	Pulp of wood and paper products	5.2	0.3	1.0	0.3
11	Textile and textile products	393.8	23.7	39.1	12.5
12	Footwear headgear, umbrellas, walking sticks, etc.	0.5	0.0	0.3	0.1
13	Stone, plaster, cement, glass, ceramic, etc.	7.1	0.4	1.1	0.4
14	Pearls, precious stones and metals, imitation jewelry	0.1	0.0	32.7	10.4
15	Base metals and articles	89.4	5.4	33.4	10.7
16	Machinery and mechanical appliances, electrical equipment, electronics and parts	27.4	1.7	10.4	3.3
17	Vehicles, aircraft, vessels, and associated transport equipment	0.2	0.0	1.3	0.4
18	Optical, measuring, precision, medical or surgical instruments, etc.	2.0	0.1	5.5	1.8
19	Arms and ammunition	-	-	-	-
20	Miscellaneous manufactured articles	8.2	0.5	0.9	0.3
21	Works of art	0.0	0.0	0.0	0.0
	Total	1,659	100.0	313	100.0

Source: UN ITC-WITS database

Note: Sector 5 does not include mineral fuels (HS code 27)

Table A2: India's Top Ten Exports to Pakistan At HS-6 (2011)

Product Code	Product Description	Exports (US $ Million)	Share of the product in Export (%)
520100	Cotton, not carded/combed	273	16.4
230400	Oil-cake and residues, from extraction of soybean oil	168	10.1
290243	p-Xylene	120	7.2
70200	Tomatoes, fresh/chilled	65	3.9
540710	Woven fabrics of yarn of polyesters, etc.	51	3.1
71320	Chickpeas	42	2.5
390210	Polypropylene, in primary forms	42	2.5
290242	m-Xylene	41	2.5
401120	New pneumatic tires, of rubber	40	2.4
90240	Tea, black (fermented)	35	2.1

Source: UN ITC-WITS database
Note: Excluding mineral fuels (HS code 27)

Table A3: India's Top Ten Imports from Pakistan At HS-6 (2011)

Product Code	Product Description	Imports (US $ Million)	Share of the Product in Imports (%)
80410	Dates, fresh/dried	70	22.2
252329	Portland cement	37	11.7
710812	Gold in unwrought form	32	10.4
780199	Unwrought lead	14	4.4
740400	Copper waste & scrap	10	3.2
520531	Cotton yarn	7	2.3
283620	Disodium carbonate	7	2.2
252010	Gypsum; anhydrite	7	2.1
291736	Terephthalic acid and its salts	6	1.9
390421	Poly(vinyl chloride), non-plasticized	5	1.5

Source: UN ITC-WITS database
Note: Excluding mineral fuels (HS code 27)

Table A4a: India's Trade and Trade Potential with Pakistan (2011)

Trade	US $ Million (Excluding Mineral Fuels) (1)	US $ Million (Mineral Fuels) (2)	US $ Million (Including Mineral Fuels) (3)=(1)+(2)
Export	1,659	19	1,678
Import	313	39	352
Total Trade	1,972	58	2,030
Total Export Potential	15,966	9,392	25,358
Total Import Potential	3,846	1,290	5,136
Total Trade Potential	19,812	10,682	30,494

Source: UN ITC-WITS database
Note: Excluding mineral fuels (HS code 27)

Table A4b: India's Exports and Export Potential to Pakistan (2011)

Export	US$ Million	Share in Total Export Potential (%)
Exports	1,659.0	
Export Potential of Sensitive List Items	5,197.2	32.6
Export Potential of Negative List Items	7,132.9	44.7
Export Potential of Sensitive/Negative List Items	9,254.2	58.0
Total Export Potential	15,966.1	100.0

Source: UN ITC-WITS database
Note: Excluding mineral fuels (HS code 27)

Table A4c: India's Imports and Import Potential from Pakistan (2011)

Import	US$ Million	Share in Total Import Potential (%)
Imports	313	-
Import Potential of Sensitive Items	1,242	32.3
Total Import Potential	3,846	100

Source: UN ITC-WITS database
Note: Excluding mineral fuels (HS code 27)

Table A5: India's Export Potential with Pakistan at H6-6 (2011)

Product Code	Product Description	Export Potential (US$ Million)	India's Exports to Pakistan (2011) (US$ Million)
851712	Telephones for cellular networks	629.6	0.0
520100	Cotton, not carded/combed	532.8	291.9
870322	Vehicles with piston engine, of a cylinder capacity >1000cc but not >1500cc	361.9	0.0
390210	Polypropylene, in primary forms	356.7	41.2
290243	p-Xylene	308.0	210.6
90240	Tea, black (fermented)	304.2	37.3
540233	Textured yarn other than sewing thread, of polyesters, not put up for retail sale	277.0	0.1
870321	Vehicles with piston engine, of a cylinder capacity not>1000cc	263.0	0.0
550320	Synthetic staple fibers, not carded/combed/otherwise processed for spinning, of polyester	255.1	0.0
390120	Polyethylene having a sp.gr. of 0.94/more, in primary forms	226.6	11.9

Source: UN ITC-WITS database

Note: Sector 5 does not include mineral fuels (HS code 27)

Table A6: India's Import Potential with Pakistan at H6-6 (2011)

Sector	Product Description	Current Imports (US$ Million) (1)	Share of Sector in Current Imports (%) (2)	Import Potential (US$ Million) (3)	Share of Sector in Import Potential (%) (4)	Import Potential Sensitive List (US$ Million) (5)	Share of Sector in Sensitive List Import Potential (%) (6)
1	Live animals and animal products	1	0	23	1	58	5
2	Vegetable products	82	26	73	2	291	23
3	Animal or vegetable oils and fats	2	1	13	0	0	0
4	Prepared foodstuffs, beverages, and tobacco products	2	1	181	5	44	4
5	Mineral products	46	15	108	3	40	3
6	Chemical and allied products	30	10	300	8	57	5
7	Plastics and rubber	12	4	331	9	140	11
8	Raw hides and skins and leather products	10	3	98	3	-	-
9	Wood and wood products	0	0	21	1	0	0
10	Pulp of wood and paper products	1	0	24	1	3	0
11	Textile and textile products	39	12	846	22	478	38
12	Footwear, headgear, umbrellas, walking sticks, etc.	0	0	62	2	40	3
13	Stone, plaster, cement, glass, ceramic, etc.	1	0	44	1	5	0
14	Pearls, precious stones and metals, imitation jewelry	33	10	457	12	-	-
15	Base metals and articles	33	11	438	11	16	1
16	Machinery and mechanical appliances, electrical equipment, electronics and parts	10	3	338	9	52	4
17	Vehicles, aircraft, vessels, and associated transport equipment	1	0	72	2	16	1

Table A6 (cont): India's Import Potential with Pakistan at H6-6 (2011)

Sector	Product Description	Current Imports (US$ Million) (1)	Share of Sector in Current Imports (%) (2)	Import Potential (US$ Million) (3)	Share of Sector in Import Potential (%) (4)	Import Potential Sensitive List (US$ Million) (5)	Share of Sector in Sensitive List Import Potential (%) (6)
18	Optical, measuring, precision, medical or surgical instruments, etc.	6	2	300	8	0	0
19	Arms and ammunition	-	-	3	0	-	-
20	Miscellaneous manufactured articles	1	0	100	3	3	0
21	Works of art	0	0	12	0	-	-
	Total	313	100	3,846	100	1,242	100

Source: UN ITC-WITS database

Note: Sector 5 does not include mineral fuels (HS code 27)

Table A7: Pakistan's Negative List (Pakistan Customs Classification-8 Digit)

Sector	Number of Commodities on the Negative List
Auto	385
Steel	137
Paper and Board	92
Plastics	83
Textile	74
Electric Machinery	54
Pharmaceutical	49
Machinery	37
Chemicals	33
Sports	32
Ceramics	28
Cutlery	22
Glass	22
Misc. Manufactured Articles	22
Leather	19
Rubber	19
Agriculture	16
Furniture	16
Aluminum	12
Surgical	10
Footwear	7
Soap and Toiletries	7
Meters	6
Metal Products	5
Prefabricated Buildings	5
Stone & Marble	5
Wood	4
Elect. Appliances	3
Gems and Jewelry	3
Optical Fiber	2
Total	1209

Source: Ministry of Commerce, Government of Pakistan

Table A8: Pakistan's Negative List and Sensitive List

Sector	Product Description	Total number of items on negative list (1)	Share in Negative List (%) (2)	Total number of Items on Sensitive List (3)	Share in Sensitive List (%) (4)
1	Live animals and animal products	2	0.2	10	1.1
2	Vegetable products	-	0.0	17	1.8
3	Animal or vegetable oils and fats	4	0.3	13	1.4
4	Prepared foodstuffs, beverages, and tobacco products	10	0.8	15	1.6
5	Mineral products	-	0.0	3	0.3
6	Chemical and allied products	89	7.4	65	6.9
7	Plastics and rubber	130	10.8	105	11.2
8	Raw hides and skins and leather products	19	1.6	1	0.1
9	Wood and wood products	4	0.3	13	1.4
10	Pulp of wood and paper products	95	7.9	45	4.8
11	Textile and textile products	78	6.5	224	23.9
12	Footwear, headgear, umbrellas, walking sticks, etc.	7	0.6	15	1.6
13	Stone, plaster, cement, glass, ceramic, etc.	65	5.4	27	2.9
14	Pearls, precious stones and metals, imitation jewelry	3	0.2	0	0.0
15	Base metals and articles	203	16.8	116	12.4
16	Machinery and mechanical appliances, electrical equipment, electronics and parts	206	17.0	179	19.1
17	Vehicles, aircraft, vessels and associated transport equipment	181	15.0	70	7.5
18	Optical, measuring, precision, medical or surgical instruments etc.	31	2.6	7	0.7
19	Arms and ammunition	-	0.0	0	0.0
20	Miscellaneous manufactured articles	82	6.8	11	1.2
21	Works of art	-	0.0	0	0.0
	Total	1,209	100.0	936	100.0

Source: Ministry of Commerce, Government of Pakistan

Table A9: India's Export Potential with Pakistan (2011)

Sector	Product Description	Current Exports (US$ Million) (1)	Share of the Sector in Current Export (%) (2)	Export Potential (US$ Million) (3)	Share of the Sector in Export Potential (%) (4)	Negative Item Potential Exports (US$ Million) (5)	Share of Sector in Negative Item Potential Exports (%) (6)	Sensitive List Potential Exports (US$ Million) (7)	Share of Sector in Sensitive List Potential Exports(%) (8)
16	Machinery and mechanical appliances, electrical equipment, electronics and parts	27.4	2	3,986.5	25	1,653.8	23	1,286.3	25
6	Chemical and allied products	419.3	25	2,744.1	17	563.8	8	636.9	12
11	Textile and textile products	393.8	24	1,966.0	12	659.9	9	151.7	3
15	Base metals and articles	89.4	5	1,647.6	10	1,825.4	26	388.9	7
7	Plastics and rubber	140.1	8	1,519.8	10	314.1	4	560.2	11
2	Vegetable products	330.5	20	724.4	5	-	0	369.2	7
18	Optical, measuring, precision, medical or surgical instruments etc.	2.0	0	400.9	3	170.5	2	26.8	1
14	Pearls, precious stones and metals, imitation jewelry	0.1	0	269.7	2	3.2	0	-	0
4	Prepared foodstuffs, beverages and tobacco products	213.8	13	237.3	1	49.3	1	69.8	1
10	Pulp of wood and paper products	5.2	0	228.5	1	192.6	3	142.8	3

Table A9 (cont): India's Export Potential with Pakistan (2011)

Sector	Product Description	Current Exports (US$ Million) (1)	Share of the Sector in Current Export (%) (2)	Export Potential (US$ Million) (3)	Share of the Sector in Export Potential (%) (4)	Negative Item Potential Exports (US$ Million) (5)	Share of Sector in Negative Item Potential Exports (%) (6)	Sensitive List Potential Exports (US$ Million) (7)	Share of Sector in Sensitive List Potential Exports(%) (8)
20	Miscellaneous manufactured articles	8.2	0	169.3	1	110.5	2	27.5	1
13	Stone, plaster cement, glass, ceramic, etc.	7.1	0	155.5	1	145.8	2	82.9	2
3	Animal or vegetable oils and fats	0.6	0	90.0	1	14.8	0	76.5	1
5	Mineral products	3.7	0	86.0	1	-	0	-	0
12	Footwear headgear, umbrellas, walking sticks, etc.	0.5	0	64.5	0	4.0	0	49.2	1
8	Raw hides and skins and leather products	0.5	0	44.3	0	14.3	0	2.3	0
9	Wood and wood products	0.2	0	32.8	0	0.2	0	4.0	0
1	Live animals and animal products	15.9	1	24.4	0	2.8	0	13.8	0
19	Arms and ammunition	-	0	3.6	0	-	0	-	0
21	Works of art	0.0	0	0.4	0	-	0	-	0
	Total	1,658.7	100	15,948.0	100	7,132.9	100	5,197.2	100

Source: UN ITC-WITS database

Note: Excluding mineral fuels (HS code 27)

Table A10: India's Sensitive List

Sector	Product Description	Sector Wise Number of items in India's sensitive List	Sector Wise Share of items in India's Sensitive List (%)
11	Textile and textile products	182	29.6
7	Plastics and rubber	97	15.8
15	Base metals and articles	60	9.8
4	Prepared foodstuffs, beverages, and tobacco products	57	9.3
2	Vegetable products	38	6.2
6	Chemical and allied products	36	5.9
1	Live animals and animal products	28	4.6
16	Machinery and mechanical appliances, electrical equipment, electronics and parts	28	4.6
3	Animal or vegetable oils and fats	21	3.4
12	Footwear headgear, umbrellas, walking sticks etc.	17	2.8
10	Pulp of wood and paper products	14	2.3
9	Wood and wood products	11	1.8
13	Stone, plaster cement, glass, ceramic etc.	10	1.6
5	Mineral Products	5	0.8
17	Vehicles, aircraft, vessels and associated transport equipment	4	0.7
20	Miscellaneous manufactured articles	4	0.7
18	Optical, measuring, precision, medical or surgical instruments etc.	2	0.3
8	Raw hides and skins and leather products	0	0.0
14	Pearls, precious stones and metals, imitation jewelry	0	0.0
19	Arms and ammunition	0	0.0
21	Works of art	0	0.0
	Total	614	100.0

Source: Ministry of Commerce, Government of India

Table A11: India's Import Potential with Pakistan

Sector	Product Description	Current Imports (US$ Million) (1)	Share of Sector in Current Imports (%) (2)	Import Potential (US$ Million) (3)	Share of Sector in Import Potential (%) (4)	Import Potential Sensitive List (US$ Million) (5)	Share of Sector in Sensitive List Import Potential (%) (6)
1	Live animals and animal products	1	0	23	1	58	5
2	Vegetable products	82	26	73	2	291	23
3	Animal or vegetable oils and fats	2	1	13	0	0	0
4	Prepared foodstuffs, beverages and tobacco products	2	1	181	5	44	4
5	Mineral products	46	15	108	3	40	3
6	Chemical and allied products	30	10	300	8	57	5
7	Plastics and rubber	12	4	331	9	140	11
8	Raw hides and skins and leather products	10	3	98	3	-	-
9	Wood and wood products	0	0	21	1	0	0
10	Pulp of wood and paper products	1	0	24	1	3	0
11	Textile and textile products	39	12	846	22	478	38
12	Footwear headgear, umbrellas, walking sticks, etc.	0	0	62	2	40	3
13	Stone, plaster cement, glass, ceramic, etc.	1	0	44	1	5	0
14	Pearls, precious stones and metals, imitation jewelry	33	10	457	12	-	-
15	Base metals and articles	33	11	438	11	16	1
16	Machinery and mechanical appliances, electrical equipment, electronics and parts	10	3	338	9	52	4
17	Vehicles, aircraft, vessels and associated transport equipment	1	0	72	2	16	1

Table A11: India's Import Potential with Pakistan

Sector	Product Description	Current Imports (US$ Million) (1)	Share of Sector in Current Imports (%) (2)	Import Potential (US$ Million) (3)	Share of Sector in Import Potential (%) (4)	Import Potential Sensitive List (US$ Million) (5)	Share of Sector in Sensitive List Import Potential (%) (6)
18	Optical, measuring, precision, medical or surgical instruments, etc.	6	2	300	8	0	0
19	Arms and ammunition	-	-	3	0	-	-
20	Miscellaneous manufactured articles	1	0	100	3	3	0
21	Works of art	0	0	12	0	-	-
	Total	313	100	3,846	100	1,242	100

Source: Ministry of Commerce, Government of India

[i] Excluding mineral fuels.

[ii] The negative list specifies the banned list rather than the permitted list of imports from India. The sensitive list consists of items on which tariff concessions are not allowed in order to protect domestic markets. Pakistan imports from India a list of items permitted for import from India- collectively known as the positive list

[iii] Excluding mineral fuels

[iv] HS refers to Harmonized System of classification. HS-codes at the two-digit level are aggregated to 21 sectors

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