Indian Council for Research on
International Economic Relation

Normalizing India-Pakistan Trade

Summary of Research Studies
2014

Normalizing India Pakistan Trade

Nisha Taneja, Mishita Mehra, Prithvijit Mukherjee,
Samridhi Bimal and Isha Dayal

Trade between India and Pakistan is likely to rise in the backdrop of the Joint Statement issued in November 2011 on normalising trade relations between India and Pakistan, and the proposed grant of MFN status by Pakistan to India. This study estimates the trade potential between these countries using two different approaches viz. the trade possibility approach and the revealed comparative advantage approach (RCA) and examines the steps that should be undertaken to help realise this untapped potential.

Using the trade possibility approach, the authors estimate a trade potential of US$19.8 billion, which is 10 times larger than the current bilateral trade of US$ 1.97 billion. Of this, India's export potential accounts for US$16 billion and import potential accounts for US$3.8 billion. The potential in mineral fuels is another US$10.7 billion, of which export potential is US$9.4 billion and import potential US$1.3 billion.

The methodology to calculate the trade potential has then been extended to include only those items in which the partner country is globally competitive. The reasoning is that items with a revealed comparative advantage to export to the rest of the world are most likely to be traded between India and Pakistan. The RCA approach provides a lower estimate of trade potential of US$10.9 billion, with export potential accounting for US$7.9 billion and import potential US$3 billion. The trade potential from mineral fuels remains almost the same at US$ 10.4 billion.

The three categories with the largest export potential from India to Pakistan are textiles, chemicals, and machinery, mechanical appliances and electrical equipment accounting for 55 percent of total export potential. At a disaggregated level, the largest potential items include petroleum oils, cellular phones, cotton, vehicle components, polypropylene, xylene, tea, textured yarn, and synthetic fibre. The three categories with the largest import potential to India from Pakistan include textiles, jewellery and precious metals, and base metals, accounting for 52 percent of the total import potential. At a disaggregated level, the items with largest import potential include petroleum oils, jewellery, medical instruments and appliances, cotton, tubes and pipes of iron and steel, polyethylene terephthalate, and copper waste and scrap.

A substantial proportion of India's export potential – 56 percent – is in products that are on Pakistan's negative list for India or on Pakistan's sensitive list under SAFTA. Similarly, 22 percent of India's import potential from Pakistan is in items on the sensitive list under SAFTA. One of the highlights of the paper is the 'vulnerability analysis', done by identifying the share and potential of items in which only the exporting country has a comparative advantage. The results show that Pakistan and India are vulnerable to importing a relatively small proportion of items belonging to the sensitive and negative lists.

Pakistan's negative list indicates that the automobile and auto-component industry is the largest sector that enjoys protection from Indian imports, with prohibited items in five categories – auto, electrical machinery, textiles, steel and pharmaceuticals, accounting for almost 90 percent of India's export potential on the negative list. Of this, one-third of the potential is accounted for by the automobile sector, which has 385 of 1209 items in the negative list. In the case of agricultural products, the negative list is not likely to have much of an impact since India's export potential in the banned tobacco items is less than 1 per cent of the total export potential on the negative list. Pakistan's sensitive list under SAFTA indicates that textiles account for 24 percent of the items, but only 4 percent of India's export potential for items on the sensitive list.

The textile sector, in which Pakistan enjoys a comparative advantage, accounts for 30 percent of the items on India's sensitive list under SAFTA. Moreover, textiles account for 62 percent of India's import potential from Pakistan on the sensitive list. Most of the items on India's sensitive list are fabrics, which if allowed at preferential (lower) tariffs into India, will compete with large firms (rather than small firms) producing products of comparable quality.

An examination of trade possibilities in the services sector reflects opportunities in information technology, business process outsourcing, health care, and entertainment. Services trade would additionally require movement of people across India and Pakistan, in order to provide and consume these services.

A number of steps need to be undertaken to help realise the untapped trade potential. Several physical and regulatory impediments need to be addressed. The physical infrastructure on the land routes is inadequate although 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 containerised cargo in each other's territory without requiring transhipment of cargo at the land borders. A much larger increase in trade is expected once the road-based positive list of traded items is dismantled. Opening of land borders should also be used for connecting seaports in both countries. India could also link up with Central Asia through Afghanistan if it were granted transit rights. These measures can substantially reduce the transaction costs of trading between India and Pakistan.

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 are being addressed in India's ongoing reform process. On the other hand, it is more difficult to address "perceived" barriers that business people face in entering each other's markets. However, there is evidence that some businesses have made a bold entry with their country labels, without meeting much resistance in the other market. Exhibitions and fairs are an effective way of dealing with these perceived barriers.

Third-country traders involved in informal trade, such as those in Dubai, have played a dual role as facilitators and guarantors of trade transactions between Indian and Pakistani traders. Even as tariff and non-tariff barriers are lowered, it is only when business partnerships between India and Pakistan materialise through market forces, payments are ensured, and trust in business relationships is established that informal trade may shift to formal channels.

For deeper and stronger trade linkages, it is important that the bilateral visa regime be liberalised without compromising on security, and there is free flow of investments between the two countries. As a positive step, India has now permitted outward and inward flows of Foreign Direct Investment (FDI) to and from Pakistan. If a bilateral investment treaty is put in place, businesspersons will develop the confidence needed to invest in the other country. Enhancing communication, by facilitating people-to-people interactions and bridging existing telecom network gaps, can also prove effective in furthering India-Pakistan trade relations.

Informal Flow of Merchandise from India to Pakistan

Vaqar Ahmed, Abdul Wahab, Abid Q. Suleri and Asif Javed

Owing to the numerous trade restrictions between India and Pakistan, the current trade of $1.9 billion between the two countries is far less than the potential of around $15-20 billion. This large gap has provided a fillip to informal mechanisms through which trade takes place. This paper uses data from primary sources to provide estimates of the current size of the informal flow of goods from India into Pakistan. It also identifies products being traded as well as the nature of transit and custom issues related to these informal exchanges. Since informal trade is largely undocumented, a survey of targeted importers, exporters, wholesale retailers, transporters, custom clearing agents, Khepias and frequent family travellers has been used for this analysis.

The study estimates that the total volume of informal inflows from India to Pakistan stands at $ 1.7 billion. The main items that are informally imported in Pakistan from India include textiles, cosmetics, tobacco, spices, herbal products, jewellery, pharmaceuticals and auto parts. Textiles emerge as the single largest commodity being informally imported into Pakistan from India, constituting 75.8 per cent of the total estimated informal inflows. This is followed by imports of auto parts and tyres (9.8 per cent), jewellery items (4.3 per cent) and pharmaceuticals (3.3 per cent).

According to survey responses, informal trade with India in the automobile sector has only just started over the last year and stands at US$ 175.7 million across Rawalpindi, Karachi and Lahore. While major vehicle engine parts are imported from China, gear boxes are often imported from India through the Wagah-Attari border. About 30 per cent of the deficiency in the Pakistan market is met through imports of Indian auto parts – especially in the case of gears, differentials, tyres and windscreens. Traders at major automobile markets such as Badami Bagh (Lahore) are switching to Indian parts (from Chinese parts) owing to greater cost effectiveness, better quality and greater ease of networking with Indian suppliers.

Informal trade in tobacco items consists mostly of trade in ghutka (US$4.8 million), betel leaves (US$39.6 million), beeri, areca nuts and tobacco. There is substantial demand for Indian ghutka and betel leaves in local markets. Despite being banned in both countries, Indian ghutka makes its way to Pakistan. The route identified for betel leaves is through Kerala to Mumbai to Dubai and further to Lahore. With respect to textiles, raw silk, cotton, Banarsi saris, muslin and readymade bridal dresses are easily available and in high demand in Pakistan. The influence of Indian media plays a major role in increasing demand for fancier Indian suits, while Indian saris and bridal wear sells at substantially higher prices in Pakistan. The supply of textile items from India to Pakistan happens directly from India through family visits, traders and designers with personal clients, Khepias, etc as well as indirectly through the Afghan transit trade (ATT) channel.

The market share for Indian cosmetics is small in Pakistan compared to domestic production, but there is increasing demand for cosmetics because of the influence of the print and electronic media. A large number of international brands that are manufactured in India are also exported to Pakistan. Artificial Indian jewellery is also a popular import – especially bridal sets, lockets, bracelets and earrings. Indian artificial jewellery is considered to have a much closer resemblance to original gold items, which makes it preferable, –especially given the trend of rising gold prices. Khepias, visiting relatives, frequent travellers, Afghan traders, ATT and sea routes are some of the ways Indian cosmetics and jewellery find their way into Pakistan.

While drugs such as aspirin and paracetamol are on Pakistan's negative list, they are freely available in local markets and are popular for their lower prices. However, these medicines do not pass through the requisite laboratory tests before arriving in Pakistan, and do not meet packaging and labelling norms. An important channel for this trade is through Afghanistan, since it receives a substantial quantity of drugs from India, which are then smuggled to Pakistan. Further,

trade in herbal products is only carried out at the micro level – with the Pakistani products dominating the market. The chief reason for this is that the ingredients of Indian herbal products are not recognised in Pakistan, although both word of mouth as well as advertising has helped fuel demand. Among spices, black tea, cardamom, cinnamon, jaiphal and javitri are some of the chief traded products that have been identified. Chief routes for the transportation of spices from India to Pakistan are through the India-Kandhar channel (to Chamman border) or through the India-Kabul channel (forwarded to Peshawar).

It has been observed that Indian goods coming into Pakistan are substantially more expensive than the same items in the Indian markets. High transit costs and the falling value of the Pakistani rupee are some of the possible reasons for the price differential – especially for products like cosmetics, jewellery and bridal suits which are 60-100 per cent more expensive than in India.

The analysis undertaken in this study highlights the key items of Indian origin that are being informally imported into Pakistan and estimates the total volume of these inflows. Informal trade brings substantial gains to traders and consumers in Pakistan in the form of both lower prices as well as better quality. However, there are certain drawbacks identified such as the harm to domestic sectors like the auto industry, the loss to governments of tariff revenues and the higher costs to traders of using informal transit routes. If formalisation of these channels of trade is not brought about by the governments, then the rising consumer demand for cross border commodities would give further incentives to trade informally. It is thus recommended in the study that the MFN status be granted to India and tariff and non-tariff barriers to trade be removed so as to make formal trade more attractive. It would also be important to frequently monitor, analyse and address informal trade flows, along with the reasons behind them. Another important move towards enhancing formal trade between India and Pakistan would be to increase cellular connectivity as well as direct courier services between the two countries. Strengthening the trade-investment nexus through these policy measures could benefit the GDPs of both India and Pakistan, besides providing consumers on both sides a greater variety of products at lowered costs.

Trade Perception Survey

Sanjib Pohit, Nisha Taneja, Mishita Mehra and Prithvijit Mukherjee

India and Pakistan are in the midst of their trade normalisation process. This Trade Perception Survey was undertaken to gather the perception of stakeholders engaged in India-Pakistan trade on the extent of impediments faced by them in realizing the trade potential. The analysis is based on information collected on six indicators, namely awareness of trade policy, ease of meeting standards, market access, business facilitation, customs and documentation, and infrastructure at ports. Statistical tests conducted on data collected through the survey bring out some interesting findings on the basis of which policy recommendations can be made.

A major finding of the survey was that awareness of trade policies was much lower in Pakistan than in India. Moreover, an even more important finding was that that awareness in Pakistan was much lower about the fact that all items were permissible for import into India. This could have a huge impact on the potential for Pakistan's exports to India. Hence, the Governments of India and Pakistan, and the respective Chambers of Commerce and Industry should set platforms for disseminating policies governing India-Pakistan trade in an easily accessible and timely manner to all traders.

Meeting standards is not a major problem for manufactured goods either by Pakistani businessmen or by Indians. However Pakistani traders find it difficult to meet standards laid down by Indian authorities on agricultural products. Respondents in both countries do not expect any change in the next year. For dealing with the difficulties faced in meeting standards, providing information on regulatory regimes of the other country could prove beneficial. Moreover, since India and Pakistan are members of the International Laboratory Accreditation Corporation (ILAC), there should be a mechanism in place to accept one another's product quality certificates which would help ease trade further.

Pakistani traders perceive that they have low market access into the Indian market indicating that there is a large untapped potential. Pakistani respondents are also not optimistic about better market access in the future. Interestingly, neither country perceived country labels to have any negative impact on trade flows. However, the perception about the negative impact of political events on trade was to some extent perceived by Indian respondents but not by Pakistani traders. Increasing the number of exhibitions, which exhibit products of the other country, would play an integral role in raising the perceptions of market access for Indian/Pakistani products in Pakistan/India.

Obtaining visas and communicating with counterparts is far more difficult for Pakistani businessmen than for Indian respondents. There is less optimism amongst Pakistani respondents than among Indian respondents on improvements in the visa regime in the coming year. These perceptions hold phenomenal relevance for policy development since along with liberalizing the bilateral visa regime; there is a burgeoning necessity to improve the communication channels (especially mobile network coverage) between India and Pakistan.

Customs efficiency in terms of processing time of documents, time taken for lab testing and checks for security was seen to be the worst at the rail Land Customs Station (LCS) compared to road, sea and air ports in India. In India even though a 100 percent security check is conducted on all consignments from Pakistan, the checks were perceived as being excessive at sea ports as they were conducted only on Pakistani consignments and not on consignments from other countries. Therefore, for expediting the movement of goods, the process of electronic submission of bill of entry, randomized checking of consignments, and provision of authorized trader status should be introduced, especially at the sea and land ports.

Overall infrastructure at the sea ports was perceived to be the worst compared to that at other ports in both India and Pakistan. Congestion at the port gate was significantly higher at the road and sea ports for Indian traders but there was no significant difference between different modes for Pakistani respondents. Warehousing at the road LCS was found to be problem for Indian traders trading by the road route compared to other modes. Pakistani respondents found warehousing a problem largely at the rail and road LCS. Availability of rail wagons was perceived to be a problem on the Indian side but not as much on the Pakistan side. To deal with these issues, increasing the number of gates at customs stations and operating hours of customs would help relieve the impending problem of congestion at ports. Efficiency could also be improved by allowing containerized cargo movement via road and rail modes; along with a provision for adequate rail wagons for exports from India to Pakistan.

Overall, the highest proportion of respondents in both India and Pakistan felt that bilateral trade will increase by up to 25 percent, with the growth of exports from India to Pakistan to be greater than 10 percent for agricultural commodities; chemicals; pharmaceuticals; processed food items including biscuits; cotton; engineering and mechanical goods; glass; jewelry; metal alloys; machinery; paper; pharmaceutical items; tea; textile items including yarn and fabric; and tyres. On the other hand, imports from Pakistan are expected to increase by more than 20 percent for dates; dry fruits; gemstones; and sugar.

The largest trade expansion is expected by the road route in India while in Pakistan traders are optimistic about the largest increase through sea and road ports. With an expected increase in trade on the road route, businessmen in both countries felt that with larger volumes and new commodities in the future there would be a requirement for better logistics services than existing ones.

Quantifying the Gains from India Pakistan Trade Integration: A CGE Modelling Approach

Sanjib Pohit and Radhika Saini

The abysmally low South Asian trading relations stand in stark contrast to the worldwide trend of increased globalisation and interdependence among sovereigns. Since a large part of this anomaly can be attributed to the weak economic relations between India and Pakistan, this study focuses on assessing the impact of bilateral trade liberalisation on these economies as well as the rest of South Asia. Using a global computable general equilibrium model, the paper estimates the potential benefit to South Asia under various simulations of trade liberalisation. The impact of bilateral trade liberalisation was calculated under three policy simulations of (1) full liberalisation between India and Pakistan, (2) full liberalisation as well as 50 per cent productivity improvements in all modes of transportation between India and Pakistan and (3) full liberalisation, 50 per cent productivity improvements in all modes of transportation between India and Pakistan, as well as full liberalisation in FTA (in force) signed by India and Pakistan. The welfare effects were then assessed for South Asian countries in each of these hypothetical scenarios.

Under the first simulation, India's welfare rises by US$282 million, while Pakistan benefits to the tune of US$41 million. However, a significantly larger jump in gain to both countries can be seen under the second simulation of productivity changes in the modes of transportation. In this scenario, India's welfare increases US$1.5 billion, while that of Pakistan's goes up to US$271 million. Owing to a fall in the terms of trade in the third simulation, India's welfare increases 4 times over its benefit in simulation 2, while that of Pakistan falls.

On analysing the welfare impact on major macroeconomic variables within these countries, it is further seen that GDP improves for both countries under all three scenarios. India's (Pakistan's) exports increase 0.13 per cent (1.1 per cent) in simulation 1, 0.23 per cent (1.3 per cent) in simulation 2 and 4.33 per cent (7.27 per cent) in simulation 3. Imports for both countries also registered a rise under all three assessments (with the largest increase under simulation 3), while the trade balance with the world declined for India and Pakistan under all the forms of trade liberalisation.

Looking at the sectors where the gains from bilateral trade liberalisation would be greatest within each country, it was found that the largest export growth from India to Pakistan in percentage terms occurs in sectors like motor vehicles and parts, leather products, wearing apparel and transport equipment. However, to account for the possibility of large percentage changes owing to a smaller base, absolute export changes are also calculated and it is seen that in India, sectors such as heavy machinery, chemicals and agricultural products stand to gain in absolute terms. Regarding Pakistan's exports to India, the maximum increase in sectoral exports to India is expected to be registered in extraction, agricultural products, transport equipment, light manufacture and wearing apparel in percentage terms, while in absolute terms agricultural products, heavy machinery and textiles are expected to show significant export gains.

Following the analysis on sectoral export changes, output changes within the various sectors in India and Pakistan were also examined. Under simulation 2, India's output in textiles, wearing apparel, leather products, electronic equipment and sea transport services is expected to contract; the maximum output growth is expected in those sectors where export growth is foreseen, such as chemicals, processed food and heavy manufacture. On the other hand, in Pakistan, the output of extraction, processed food, leather products, light manufacturing and, chemical and rubber sectors are all expected to fall.

The study also assesses the impact of trade liberalisation on other countries. As expected, under simulation 2, those countries that do not reduce tariffs would lose welfare. However, under simulation 3, ASEAN members gain significantly. While Malaysia (US$706 million), Singapore (US$374 million), Nepal (US$135 million) and Japan (US$839 million) all benefit substantially, there are some losses to Sri Lanka (US$55 million) and China (US$90 million).

It can be concluded that there is potential for significant mutual gains from trade liberalisation between the two countries. While this benefit extends not just to India and Pakistan, but to several other nations, it can only be realised when there is productivity gain in the modes of transportation services between India and Pakistan. This is to be expected given the current logistics problems between India and Pakistan.

Trade in Services between India and Pakistan

Rupa Chanda

This paper examines the scope for expanding trade between India and Pakistan in the area of services. Improved trade relations in services between the two countries would not only help diversify the trade basket and build confidence through cross-border movement of people but also create synergies for merchandise trade through co-operation.

While there has been high growth in the services sectors of both countries over the last two decades, it has been stronger and more consistent in India than in Pakistan. Similar trends are also reflected in the services trade flows of the two countries. This sector constitutes a little over 30 per cent of India's total export basket, but remains less than 20 per cent for Pakistan – making India the chief driver of services trade in South Asia. However, with services occupying over half of GDP in India and Pakistan, it is a matter of concern that the sector's role as a source of employment has not been commensurate with its growing share in output. The agricultural sector continues to account for the majority of the labour force in both countries. A sub-sectoral analysis further revealed that while the greatest growth momentum in services exports in India came from computer and information services and other business services, over half of Pakistan's service exports were government services – implying no significant areas of commercial competitiveness in Pakistan. Although sub-sectors such as transportation, business, computer and information and communication services show some potential in Pakistan, the country does not currently account for a noteworthy presence in global services exports for any of the commercial services segments. Given the large differences in the relative nature and sizes of the services sectors between the two countries, there is more scope for complementarity and collaboration as opposed to competition between India and Pakistan.

India accounts for less than 0.5 per cent of Pakistan's commercial services exports to the world. This is not just a lower share than Pakistan's exports to its major partners such as US, UAE, UK and the rest of EU, but is also lower compared to other Asian countries which are smaller players in the global services market. Pakistan's service exports to India mostly consist of communication and other business services exports, while the chief import from India is transport services. However, this trade pattern is incongruous with the RCA's of the two countries, indicating that there are barriers to trade in services between India and Pakistan and that there is some scope to expand trade relations and set up collaborations and tie ups across sectors. It was overall inferred that the services trade basket between India and Pakistan is narrower than it is with other countries and that cross border supply-based trade in services (such as communication and transport services) is performing better than other modes of trade in services.

The paper further goes on to examine the opportunities and constraints within India and Pakistan, specifically for IT-BPO, tourism and health services. In India, IT and BPO service exports have risen from $754 million in 1995/96 to $88 billion in 2011, and the IT sector forms around 25 per cent of India's total export basket today. In Pakistan too, both IT and BPO industries have grown rapidly – with the latter registering an annual average growth rate of 33 per cent. For both countries, the cost advantage stems from their large pool of English speaking graduates, who are willing to accept lower wages than those in the US. Given the common export orientation towards the US and the UK, there is some competition between India and Pakistan in this sector. However, the overlap also implies a similarity of challenges for the two countries. This could encourage tie-ups and collaboration between Indian and Pakistani firms to address Pakistan's constraints of scale, reputation, marketing and diversification, as well as help India overcome the challenges of rising wages, need for quality manpower, growing competition and the need for diversification.

However, in the current scenario, the magnitude of IT and BPO services trade between the two countries continues to be very low, owing to the various barriers between India and Pakistan. These include the absence of MFN status by Pakistan's government to India, restrictions on investment by Indian IT companies in Pakistan, lack of a supportive visa

policy and corporate regulations. A possible way to circumvent these problems could be for both countries to set up offices in a third neutral country (like Dubai or Singapore) as joint ventures.

Alternatively, Indian and Pakistani companies could engage strategically to tap other markets, or increase trade through exports of Indian software products to Pakistani banks and vice versa. Despite these options, the outlook for engagement is not too optimistic given the difficulties in obtaining visas, setting up offices and mobilising people. The promotion of bilateral ties in this sector would require several steps by the governments of these countries, including co-operation agreements and the provision of official sanctions to business initiatives in the IT sector.

With respect to the health sector, both India and Pakistan share common challenges in the form of low quality, lack of equitable access to healthcare and under-allocation of resources. While India is seeing a rise in cross-border investments by Indian hospitals, medical tourism and telemedicine links with other South Asian hospitals, concerns remain about shortage of trained specialists, difficulties relating to regional mobility of professionals and lack of recognition of qualifications. Pakistan has high potential for trade in health services through all modes of supply and enjoys the advantages of good doctors, low costs and competitive private hospitals. Major areas of potential in bilateral trade between India and Pakistan lie in medical tourism and improved telemedicine links. A large number of patients already travel from Pakistan to India for medical treatment – especially in the areas of organ transplant and fertility treatment. However, medical tourism is constrained by lack of health financing arrangements, fragile political relations, poor infrastructure and weak airline connectivity, while telemedicine faces problems relating to technology and telecom infrastructure and unreliable patient confidentiality. FDI as well as visa issuance are both especially hampered by political tensions and safety considerations. In the face of these constraints, the possible steps to be taken for boosting trade in health services would include establishing insurance, creating cross-border payment arrangements, launching pilot schemes for specialised elective treatments and procedures and addressing the issues of visas, transportation and other supporting logistics.

The third subsector analysed in this study for India and Pakistan is the tourism industry. India has seen an expanding tourism industry with a CAGR of 8 per cent from 2001-2010. While there has been growth in value, employment, arrivals and investment in the Indian tourism industry, the sector exhibits slow overall growth due to lack of management, marketing, infrastructure, hygiene and sanitation. However, it is expected that by 2020, India will be the leading tourism destination in South Asia with 8.9 million arrivals. On the other hand, foreign visitor exports and tourist arrivals in Pakistan have declined or stagnated in recent years as has capital investment, reflecting safety concerns in the face of an unstable political environment. Despite important facilitating factors such as language, culture, social and family ties as well as geographical proximity, the extent of bilateral tourism flows between India and Pakistan remains very limited. The primary reason for this lies in the tense political relations of the two countries, with the number of tourists fluctuating according to the political scenario at any point in time. However, given the number of places of worship for Muslims in India, as well as for Sikhs or Hindus in Pakistan, there is still scope for improved bilateral tourism if the two countries leveraged their previously mentioned commonalities. Other areas where tourism has potential would be sports (especially cricket) as well as family tourism. Unfortunately, key issues such as visas and transportation connectivity would still need to be tackled before the full potential of such tourism can be met.

While trade in IT-BPO, health and tourism sub-sectors all have large potential for growth and expansion, the broader challenge for exploiting trading opportunities would be determined by the regulatory and business environments in India and Pakistan. There has been considerable FDI liberalisation in both India and Pakistan, across many services and to varying degrees. Despite this, several restrictions continue to hamper bilateral trade. Market structure conditions and monopolistic public sector enterprises undermine market access at the border for services like electricity and airports. Despite being the largest and most dominant player in services in South Asia, India imposes major restrictions on foreign

equity ownership and has the worst liberalisation indicators in the region for several services. In Pakistan too, while manufacturing and primary industries are fully open to foreign equity ownership, there are other service ownership restrictions in the form of residency and nationality requirements, government approvals, minimum investment requirements and FDI ceilings. In spite of liberalisation at the border, the continued presence of these "behind the border" barriers implies that India and Pakistan both rank extremely low on business environment indicators as well as global competitiveness rankings. The countries also perform poorly on trade policy restrictiveness indices, with India being even more restrictive than Pakistan.

Overall, there is a strong need to address the different regulatory constraints in both countries as bilateral trade liberalisation cannot be fruitful without this. Further, the numerous supply-side concerns of infrastructure, transport and logistics would also have to be tackled to facilitate successful trade. To achieve these objectives, not only will the private sector be required to build production networks and supply chains, but the governments of the two countries must also play a major role in confidence building and promotion of good will. Faster clearances and transparency of information for investment, simplification of the visa issuance process for greater mobility and discussions between regulatory bodies of both countries for regulatory co-operation are some of the recommended ways forward. Overall, it would be useful to begin by liberalising the more contentious services such as tourism or IT and then use an incremental, phased and prioritised approach to cover the remaining sectors.

FDI in India: Prospects for Pakistan

Abid Q. Suleri, Vaqar Ahmed and Muhammed Adnan

The liberalisation of FDI regulations has transformed India into one of the fastest growing destinations for global investment inflows. The total investment inflow in India has increased rapidly from US$9 billion in 2005-06 to its highest ever level of US$46.6 billion in 2011-12. In the spirit of normalisation of bilateral relations as well as liberalisation of investment inflows into India, the Government of India revised its consolidated foreign policy and permitted Pakistani citizens and entities to invest in India through the government route (in sectors/activities other than defence, space and atomic energy) in August 2012. This paper provides estimates of possible investment from Pakistan into India based on a perception survey. The study focuses on the preparedness of Pakistan's private sector to take advantage of this opportunity. It further highlights Pakistan-specific investment opportunities in India and elaborates upon the concerns of Pakistani investors regarding FDI in India.

In 2011-12, foreign investors made substantial investments in India's chemical sector, which contributed 19.9 per cent of overall FDI flows to India. Other sectors attracting FDI are services, housing, real estate and construction, and drugs and pharmaceuticals. Mauritius, UK and Singapore are the top sources of foreign investment in India. Analysing India's investment inflows from the world on a sectoral basis, between 2000 and 2012, the services sector had the largest share in total FDI (19.4 per cent), followed by the construction sector (12 per cent) and telecommunication (6.7 per cent). Further, in 2011-12, Mumbai was the largest recipient city for FDI inflows, with New Delhi being the second largest. Chandigarh and Rajasthan have been recognised as cities with strong potential for future returns since they are neighbours with Pakistan.

As a first step in estimating potential Pakistani investment in India, the paper estimates the current levels of outward flows of equity to the UAE (US$670million), Afghanistan (<US$700million), Malaysia (<US$600million), Bangladesh (<US$30million) and Sri Lanka (>US$0.15million). Next, key Indian sectors that could be attractive for Pakistani investors were identified through interviews with Pakistani investors and other relevant entities. The top ranked sectors included textiles, cement, hotels and restaurants, auto sector, sugar and wheat products, and banking and insurance. For each of these identified sectors, the authors consider the minimum amount of annual investment outflow during the past three years. Using these values, it was estimated that the total annual potential investment from Pakistan to India stands at US$1.6 billion if both the government and automatic routes were opened. The textile sector tops the list (potential of US$760million), comprising 47 per cent share of the total estimated FDI outflow. This is followed by the cement, auto sector and food processing sectors on the industrial side and hotel-related services, and banking and insurance on the services side. Already two Pakistani banks have applied for licences in India to initiate operations, while firms such as SEFAM (textiles) and Lucky Cement have approached the FIPB with investment proposals.

While survey results indicate that high-end investors were attracted to India as an investment destination, medium-end businesses felt that India presents little reward compared to the high risk for Pakistani capital in India. Their reasons for unease included laxity on the part of the governments of both countries regarding security of assets and profits in case of political upheavals. At a sectoral level, leather sector producers were apprehensive about finding labour with appropriate training and expertise at desired prices in India. However, they were interested in introducing the technology practised in Sialkot across the border in Punjab, which may imply accompanying vocational training. In the engineering (particularly auto sector) sector, producers were of the view that Pakistan already had substantial import demand of raw material from India and that access to subsidies and finance in India would increase their margin.

With respect to the surgical and sports goods sectors, it is important to strengthen competition policies in both countries and practices such as price wars need to be checked. Another factor that discourages investors is their fear of breach

of intellectual property, especially through techniques of reverse engineering by China. In the food processing sector, there exists rising demand in India that continuously outpaces the supply – suggesting that Pakistani investors could enter this sector. For this exchange of mass cargo, open- roof containers should be allowed between both countries, enhanced presence of plant department officials on both sides is necessary and mutual recognition of product standards must be allowed.

In case of the services sector, it was found that while the banking sector had a fair idea that it would have to follow the licensing route allowed by the Reserve Bank of India, there were other services subsectors that were still waiting for information regarding the rules governing FDI in India. The paper describes the difficulties faced by the education and health sectors. With respect to education, registration with national and local educational authorities, bilateral e-commerce facility, cross-border cellular service and direct courier services are missing. Moreover, the visa policy for Pakistani faculty and students is city-specific and students and teachers are not allowed personal bank accounts in India. Similarly, in the health sector, there is no guarantee of expedient visas for emergencies, no private flights are allowed for health stakeholders and secure direct conferencing protocols must be ensured for cross-border medical operations. The South Asian Free Trade Area emphasises the removal of barriers to intra-SAARC investments. A SAARC Arbitration Council has also been set up to strengthen the resolution mechanism of trade and investment disputes among South Asian nations.

The business community observed that the provisions under India's 2012 consolidated FDI policy would have to be revised to allow Pakistani investment via the automatic route. Some possible changes in India's investment regime would include the relaxation of various clearances from the offices of FIPB, RBI and state-level institutions for Pakistani investors and the removal of sectoral caps on investment such as those on telecommunications and banking. Agricultural activities allowed under this policy document were fairly narrow with laws prohibiting/restricting activities involving the setting up of milk processing plants.

Even though the consolidated policy allows for repatriation of dividends freely, this is not possible for Pakistani investor unless branches of Pakistani banks are allowed to open in India. In the absence of such a mechanism, profits to Pakistan are routed through third-party banking arrangements, which raise issues of double taxation and overseas transactions tax.

A primary policy recommendation that this analysis suggests is that Pakistan should be allowed to invest in India through the automatic route to lower the current transaction costs currently faced by Pakistani investors. Second, a privileged visa facility must be granted to investors so that they can access their investments at will with certainty. A joint working group of the Board of Investment (BOI) and Foreign Investment Promotion Board (FIPB) could be set up to achieve these two objectives. Thirdly, investors need to be assured of the security of their assets and profits by establishing of investment-specific dispute resolution mechanisms. Another important policy measure would be to ensure availability of integrated transport and warehousing infrastructure. Containerisation via railways and increasing the capacity of custom houses and storage facilities would be the short-term measures required to smoothen cross-border investment. Fifth, Pakistani investors demanded initiatives in the financial sector. These include access to the Indian financial markets on the same footing as domestic Indian firms, addressing the double taxation issue and possible currency swap agreements between the State Bank of Pakistan and the Reserve Bank of India. Finally, the fixed assets and intellectual property of foreign investors should be provided a legal cover.

India Pakistan Bilateral Trade in Sports Goods Sector

Hadia Majid, Kiran Javaid and Farah Shahid Hassan

Despite sharing a common border, India and Pakistan have minimal bilateral trade. While the share of Pakistan's trade with India as a percentage of its total trade has risen from 0.61 per cent in 1995 to 4.68 per cent in 2010, the current volume of trade is not proportionate to its potential. A variety of political and infrastructural impediments have hindered bilateral relations between India and Pakistan, but the two main reasons usually quoted for the weak trading relations are Pakistan's reluctance to grant India MFN status and the presence of non-tariff barriers in both countries. Despite these obstacles, the trade potential, possible joint ventures and other forms of co-operation have been recognised between India and Pakistan, especially in sectors like textiles, agriculture, sports goods, engineering, pharmaceuticals, rubber and plastic. This paper looks at the trading patterns between India and Pakistan in the sports goods sector.

In Pakistan, Sialkot has historically been the centre of the sports goods industry owing to the easy availability of skilled, cheap labour along with the availability of basic infrastructure in the form of a dry port and an international airport. The sector produces almost all sports-related items including articles for gymnastics, athletics, fishing, billiards and fun fairs. Pakistan also produces sports bags, sports jackets and sports gloves and is a leading manufacturer of footballs, cricket balls, hockey sticks and cricket bats. Most of these goods are produced in small scale industries and their high quality ensures demand from major brands like Nike, Adidas and Puma. Overall, the Pakistani sports sector contributes significantly to the economy, providing employment to over 300,000 labourers and constituting 1.42 per cent of the country's export base.

In India, Jalandhar is the major centre of the sports goods industry followed by Meerut and Gurgaon. The sports sector in India has shown immense potential for export, growth and employment generation, chiefly due to the sector's high labour productivity, low wage rates and the progressive adaptation of the sports industry to technological advancements. Significant exports from the Indian sports goods industry include inflatable balls, hockey sticks and balls, cricket bats and balls, boxing equipment, fishing gear, indoor games and protective equipment. The Indian sports sector also contributes substantially to rural and urban employment and the industry exports to over 130 countries.

The products of the sports sectors in the two countries are divided into three main categories – sports equipment, sports apparel and sports footwear. Pakistan's chief exports are sports equipment, followed by apparel and very small quantities of footwear, while for India the major exports are equipment, followed by footwear and then apparel. Overall, the absolute value of Pakistan's exports in the sports sector is much higher than that of Indian exports, but India's exports in footwear are higher than those of Pakistan's. Also, India's exports of sporting goods are rising rapidly, due to which the total export values of the two countries show a converging trend.

While the contribution of India's sports goods industry as a percentage of GDP has been stable over time, its contribution in Pakistan has seen a downward trend over the last few years. However, the ratio of sporting goods to GDP is substantially higher for Pakistan than for India, indicating that the sports sector forms a more important part of the Pakistani economy than of India's.

Bilateral trade between India and Pakistan has seen an increasing trend over the last few years for the sports sector, with India's exports to Pakistan being greater than that of Pakistan to India. Pakistan forms a more important export partner for India than the converse as Pakistan exports a higher percentage of sporting goods to countries other than India. It was further seen that the two countries have advantages in similar product categories, barring India's advantage in sports footwear. India's exports to Pakistan are driven by one chief product – inflatable balls; other categories form a very small proportion of exports. While India does have a comparative advantage in this product, there are twelve other

product lines in the sports sector in which India is even more competitive, including golf equipment, water sports equipment, track suits and sports footwear. Pakistan's exports to India are also in products in which it has a comparative advantage, but these exports are more diversified. The major exports comprise outdoor sports equipment, inflatable balls and sports gloves.

This paper recommends that India and Pakistan should concentrate on trading in products in which they have a comparative advantage. Further, India's competitiveness in sports footwear should be taken advantage of, as currently trade in this category does not exist.

The trade concentration index for Pakistan has fallen from 44 per cent in 2009 to 32 per cent in 2011, while India's trade concentration is expectedly higher at 56 per cent in 2011. Since only a few products dominate bilateral trade and both countries produce differentiated products; there is large scope for intra-industry trade. Bilateral trade in the sports sector exhibits elements of both inter and intra-industry trade. While there is intra-industry trade in product categories such as balls and sports equipment, trade in other product lines constitutes inter-industry trade.

This study also estimates a gravity model for India, Pakistan and their trading partners. The simple gravity model confirmed that the GDP of the exporter and importer countries affects trade positively, while distance, being a measure of transportation costs, has a negative impact. The augmented gravity model further showed positive coefficients for the dummy variables of contiguity, common official language and historical integration of the two countries. The most significant result that emerged from the gravity model was the large negative coefficient of India and Pakistan's bilateral trade – which suggested that, India and Pakistan trade 288 per cent less than a similar country pair as per the pooled OLS model and 249 per cent less than a similar country pair according to random effects model. This could in part be attributed to the presence of numerous non-tariff barriers to trade. Overall it can be concluded that there is great potential for trade between these two countries and both should try and increase trade based on their respective comparative advantages.

Trade between India and Pakistan in Textiles

Saon Ray, Mishita Mehra and Prithvijit Mukherjee

Textiles and clothing are important components of bilateral trade between India and Pakistan, accounting for 22 per cent of the total trade between the two countries. Ninety-nine per cent of this trade is in textiles – primarily in cotton in which both India and Pakistan are competitive. However, there are a number of other items in this sector that India and Pakistan could export to one another, but are unable to, owing to restrictive sensitive lists on both sides. As such, this paper estimates that the potential for trade in textiles between the two countries is large and currently lies at around five times the current value of exports. The study also analyses the current trends in trade in the textile industry and identifies avenues for further bilateral engagement in this sector.

In India, the textile industry remained extremely restrictive till the 1980s. However, the new industrial policy announced in 1991 brought radical changes in this sector, including the removal of the textile industry from licensing requirements and the exemption of small-scale and ancillary industries from location restrictions. In the year 2000, The National Textile Policy implemented recommendations of the Satyam Committee Report to strengthen the textile sector; the most significant change was the re-diversification of the knitting and garment sectors from the small scale industries. Following this, in 2002, 12 items were removed from the list of essential commodities and subsequently, in 2006, cotton was moved from this list as well. Two other policies that have been pertinent to the development of the textiles industry in India have been the implementation of the Technology Upgradation Fund Scheme and the Technology Mission on Cotton. Despite these continuing efforts towards liberalising the textile industry and making it more competitive, productivity in this sector remains low. The vintage of machines used for production is very old; about half the shuttle-less looms are second-hand machines and the quality of yarn is very poor. Further upgradation of machinery is also needed.

The textile sector plays a significant role in Pakistan's industrial development, accounting for 54 per cent of the total export earnings of the country. The sector forms 46 per cent of total manufacturing and employs 38 per cent of the manufacturing labour force in Pakistan. Consequently, several policies have been undertaken to boost the performance of the sector. A Textile Vision was developed in 2005 that suggested three different scenarios for growth and a number of measures for the promotion of trade and investment were undertaken based on its recommendations. Further, Rs.123 billion has been allocated under the Strategic Trade Policy Framework (STPF) to increase textile exports in Pakistan. One of the key features of this policy is the establishment of a Textiles Investment Support Fund for incentivising investments in specific areas including modernisation of machinery and technology, removing infrastructural bottlenecks, enhancing skills, better marketing and use of information and communication technology. A Technology Upgradation Fund was also announced for part financing of capital intensive projects. Schemes have also been proposed for the development of infrastructure, establishment of industrial estates to ensure availability of industrial amenities, skill development and sub-sectoral initiatives for ginning, spinning, weaving knitting, processing, fashion design, handlooms, carpets and technical textiles. Overall, the textile made-up sector, comprising towels, tents and canvas, cotton bags, bed-wear, hosiery, knitwear and readymade garments, is the most dynamic segment of the Pakistani textile industry.

At present, trade between India and Pakistan in the textile industry is limited while that in clothing is negligible. The top commodities exported by India to Pakistan are cotton, not carded or combed, and woven fabrics of synthetic yarn. On the other hand, India's chief imports from Pakistan are woven cotton fabrics, waste of wool or animal hair and cotton, not carded or combed. As a first step towards computing the trade potential between the two countries, the commodities in which India and Pakistan have a comparative advantage were identified. While the countries showed a comparative advantage in cotton products, in the category of manmade filaments, India enjoyed a comparative advantage for more than twice the items for which Pakistan did. However, a large number of these commodities that India could export to Pakistan are on the Pakistani sensitive list, including synthetic textured yarn, synthetic yarn, synthetic woven fabrics and

synthetic staple fibres (not carded). Similarly, the Indian sensitive list bans many items in which Pakistan is competitive, such as cotton (not carded/combed), t-shirts, singlets and vests, men's/boys' trousers and women's/girls' trousers. The intra-industry trade index for India and Pakistan is found to be low and has in fact declined in the period 2005-11 for cotton, man-made staple fibres and apparel items. On the other hand, for product groups such as vegetable-textile fibres, wadding felt and non-wovens, the index has increased.

An extremely useful addition to this analysis is a survey conducted across India to estimate current trends in production and trade in different commodities in the textile sector. The survey finds that cotton production in India is concentrated in Gujarat, Maharashtra and Andhra Pradesh, with Gujarat accounting for the highest production. While India's total production of cotton is higher than in Pakistan's (owing to almost double the acreage), the average yield in India is lower. With respect to spinning, India and Pakistan have the second and third largest spindle capacities in the world respectively. While both countries are extremely competitive in this segment, India has a higher production and larger exports to the world than Pakistan. Some reasons for this are the better quality of Indian cotton, more modern machinery and the success of the TUFS scheme. On the other hand, the Indian weaving industry is relatively underdeveloped as 40 thousand looms have old technology and 80 per cent of the shuttles-less looms are second hand. Conversely, Pakistan generally produces a standard quality of yarn and has important brands such as Fax and Kohinoor. The Pakistani weaving industry is also very strong with advanced wider width looms. In the last 10-12 years, there have been massive investments in denim wear in Pakistan and due to their good quality cotton and low yarn count, Pakistani jeans are sourced to major global brands. Overall, both countries have witnessed a shift from weaving to knitting, although in Pakistan, woven fabrics still dominate.

Despite being self-sufficient in fabric production, India imports fabric from Pakistan because the bilateral exchange rate that favours Pakistan and because of the Indian trade policy, which incentivises the imports of raw material for exports of final goods. Pakistan is the second largest exporter of home textiles in the world and a large proportion of fabric is used for made-up in comparison with India. Pakistan's textile industry is looking to expand to India's market for made ups because of India's large market for household products - owing to its expanding realty sector as well as the rising middle class.

The analysis also included an assessment of synthetics, knitwear, jute and silk. India has a clear advantage over Pakistan in manmade fibres (MMF), but is not price competitive. With the rising global demand for MMF, the Indian textile industry must develop a competitive edge in this segment. The survey showed that MMF producers and exporters felt that the cotton industry in India should be taxed, as the MMF industry has to face higher costs and prices and receives no benefits from the government. With respect to knitwear, there has been hardly any growth in trade between the two countries because of the higher competition in this segment. Pakistan is very competitive in the production of lowers and while India produces both uppers and lowers, it is not as competitive. On the other hand, India has a larger production base of both jute and silk than Pakistan. The Indian textile machinery sector is also growing and there is a huge potential market in Pakistan for Indian textile machinery. With the introduction of the negative list in Pakistan, companies no longer have to route their exports through Dubai – implying that trade in textile machinery has the potential to double to Rs.500 crore. Unfortunately, political events and anomalies in the policy regimes of the two countries continue to inhibit this potential.

Although the current level of bilateral trade between India and Pakistan is low, it has been growing, especially in areas like raw cotton, yarn, grey fabric, textile machinery and textile chemicals. There is huge potential for trade in textiles between the two countries; for instance, India could import lower count of yarn (less than 20) from Pakistan. India could also take advantage of Pakistan's relative strengths in the weaving segment, the production of lowers and Pakistan's competitiveness in the production of bed linens and towels. Similarly, Pakistan could import Indian cotton yarn of 30-80 counts, as well as textile machinery for which it currently relies heavily on Europe and China. There is also scope for Pakistan to import textile consumable spare parts (in which India is very competitive) and textile chemicals.

India-Pakistan Trade: An Analysis of Health Sector

Hadia Majid and Nadia Mukhtar

Intra-regional trade in South Asia is meagre in spite of the reduction in tariffs under SAFTA, as successful integration of the South Asian countries hinges on the normalisation of trade between India and Pakistan. Bilateral trade between these countries has picked up since 2011 owing to a wave of trade negotiations, and in March 2012, Pakistan dismantled its positive list, finally adopting a negative list instead. Despite the recent initiatives taken by both sides as well as the increasing likelihood of Pakistan granting India MFN status, Pakistan's exports to India form only 1 per cent of total exports, while India's exports to Pakistan constitute a mere 0.9 per cent of total exports – indicating substantial potential for further trade. This paper examines trade potential with respect to the health sector, as a solution to the dire condition of Pakistan's health services. India's high quality medical treatment and personnel could become a boon to patients in Pakistan. On the other hand, health-related commodities – especially pharmaceutical and surgical goods' manufacturing have been performing well in Pakistan. Given Pakistan's burgeoning performance in health commodities, and India's flourishing health services sector, this paper examines the synergies between the health sectors of the two countries.

This study analyses the trading patterns and potential in the case of three main commodities – surgical instruments, pharmaceutical products and medical equipment. Pakistan has a trade surplus with the world in surgical instruments, and while the share of exports to India in total exports of surgical goods is 2 per cent, the share of imports is a paltry 0.2 per cent. With respect to pharmaceutical products, Pakistan is an overall importer, and India's total share in imports and exports (4.9 per cent and 3 per cent respectively) is higher than its share in surgical goods. Pakistan is also an overall importer of medical equipment. There are no exports to India in this sector, while the import share is also low at 0.2 per cent. These values reflect the negligible existing trade in health products between India and Pakistan. This could be because of protectionist domestic policies, non-tariff barriers, weak intellectual property rights or lack of concerted effort by the health sectors of the two countries.

On analysing trading trends for these commodities from 2003-11, it is observed that the export of surgical instruments to India exhibits an upward trend that far outweighs the exports of the other two, while imports of pharmaceutical products from India are significantly higher than the imports of surgical and medical equipment. Direct trade in surgical goods with India is driven only by a few Pakistani producers (such as Hilbro Instruments Pakistan) with large individual market shares. A large part of surgical exports to India are routed through Germany and Dubai.

With regard to pharmaceutical products, the Indian pharmaceutical industry is much larger than its Pakistani counterpart, with a world market share of 1 per cent in terms of value and 8 per cent in terms of volume. Given that the Indian pharmaceutical sector is expected to grow to $16.9 billion by 2014 (at least $55 billion in 2020), Pakistan could gain by importing drugs in bulk from India, especially given that the Pakistani pharmaceutical industry is expected to reach only $2.12 billion in 2019. The huge shortages, higher prices and overall inequity in access to drugs in Pakistan necessitate addressing the issue of low existing pharmaceutical trade between the two countries. However, barriers to trade such as SPS requirements, domestic lobbying as well as the lack of a strong intellectual property rights framework discourages the export of Indian pharmaceuticals and biopharmaceuticals to Pakistan. As a result, Indian medicines are illegally imported through Afghanistan into Khyber Pakhtunkhwa (KPK) along the Pak-Afghan Border. India's policy environment is also more favourable for the manufacture of pharmaceuticals as in-house R&D is supported via tax deductions and import duties are waived on raw material. The same is not true for Pakistan, which suffers from inadequate policies, lack of infrastructure and energy shortages. It can be concluded that India's edge in the pharmaceutical industry could bode well for Pakistan as the Pakistani pharmaceutical sector could collaborate with Indian drug companies to improve its terms of trade by producing high-end medicines using joint R&D.

Trade in health-related commodities has both inter and intra industry characteristics. The figures for India's trade with the world reveal that approximately 50 per cent of trade in the three commodities is at the intra-industry level. The corresponding Pakistani figures show more variation, as 8 per cent of medical equipment, 36 per cent of pharmaceuticals and 73 per cent of surgical goods are exchanged for goods in the same industry. Trade between India and Pakistan for these commodities is predominantly inter-industry in nature, with intra-industry trade being below 1 per cent for all three commodities. Moreover, both import and export trade intensities are far below the maximum values of 100. These figures indicate that there is potential to improve bilateral trade between India and Pakistan.

For the surgical sector, India's top exports to Pakistan are catheters and cannulae, and Pakistan's only exports to India are instruments and appliances used in medical, surgical, dental and veterinary sciences and dental apparatus. Within the pharmaceutical sector, Pakistan's top imports from India are antibiotics, blood, antisera, vaccines, toxins and cultures as well as medicaments mixed together for therapeutic use. Trade in the medical sector is nominal. Pakistan by and large, imports only apparatus based on the use of X-rays, while India imports artificial parts of the body other than artificial joints, artificial teeth and dental fittings, along with some parts and accessories for apparatus based on the use of X-rays from Pakistan.

This paper further analyses trade in health services on two main fronts: (1) collaborative research in medicine/ pharmaceuticals and (2) exchange that involves the mobility of people. In terms of research collaboration, there has been no institutional level involvement between the two countries and the few cases of collaborative work or cross-border conferences are conducted with little state involvement. Similarly, despite the extremely low doctor-population ratios on either side of the border, there is no student exchange or common training programme in health between India and Pakistan. Given the similarities in the disease environment, physical contiguity and commonalities of culture and language between India and Pakistan, there is substantial scope for cross-border co-operation in higher education as well as science and technology, especially in the health services and sciences sector. While there is evidence of Pakistani patients seeking treatment in India, the political mistrust and difficult visa regimes constrain this medical tourism.

Overall, identifying the drivers of trade in the health sector suggests that Pakistan does in fact import from the world those commodities that are India's leading exports to the world. The same is true for Pakistan in the surgical and pharmaceutical sectors. Thus, both countries would benefit by taking advantage of the possibilities of intra-industry trade available to them. Gains would be much higher if the Pakistani side removed leading Indian exports from Pakistan's negative list, and if Pakistani exports were allowed easier access to Indian markets as well.

India-Pakistan Energy Co-operation: Rethinking Opportunities and Newer Approaches

Mahendra P. Lama

Energy security has long been a critical issue for regional geopolitics in the India-Pakistan sub-region. The per capita consumption of energy in this region remains rather low, and the power crisis in South Asian economies results in long hours of load shedding. Consequently, the demand for energy has been steadily growing in these countries. In India and Pakistan, energy imports have ranged on average between 10 and 15 per cent of total imports, leaving both countries vulnerable to sharp fluctuations in global oil prices. With 60 per cent of India and Pakistan's energy sources providing power to the commercial sector, the management and sustainability of these resources present significant challenges. Moreover, the per-capita consumption in both countries remains low and inequitable; the energy infrastructure is of poor quality and the accessibility as well as the affordability of power is skewed. This paper focuses primarily on the power sector in the broader context of essentialities, possibilities and opportunities for energy co-operation between India and Pakistan.

Despite numerous constraints on energy supply in India and Pakistan, the changing needs of consumers, rural electrification projects and the emphasis on power driven industrialisation have resulted in burgeoning demand in both countries. However, there is an overall energy deficit of 8.7 per cent in India and a peak shortage of 9 per cent. Similarly, in Pakistan, the energy and peak shortages of power have been around 7.5 per cent and 12.1 per cent respectively. The cuts in electricity adversely affect social development and the investment climate and are currently costing the Indian and Pakistani industrial sectors 1.5 per cent and 1.8 per cent of GDP respectively. The deficits in India and Pakistan can only be met if both countries evolve a conscious policy of investments in the power sector to cater to regional needs.

Both India and Pakistan have undertaken a series of reforms in the power sector in a phased manner for over the past two decades to introduce more competition and improve the overall efficiency of the sector. For several decades, the power sector was an exclusive state monopoly and suffered from lack of accountability, excessive dependence on government subsidies, lack of commercial independence and responsibilities, high system losses and low collections from consumers. With revenues covering only a small share of investment costs, new capacity addition was also adversely affected and consequently reforms to the power sector became inevitable. In India, under the Electricity Act 2003, all distribution, trading and generation companies were to have non-discriminatory open access to inter-state and intra-state electricity transmission systems on payment of specified transmission charges. This act ushered in the era of the multi-buyer seller model, helped facilitate competition in the industry and improved efficiency levels by moving to a new regime of lighter regulation. The Integrated Energy Policy of 2006 recognised that energy security in India depended not only on diversifying the source for a particular fuel, but also on diversifying into mixing other sources of energy such as hydro power from Nepal and Bangladesh.

Reforms in Pakistan were initiated long before they were in India. With load shedding constraining growth in Pakistan, the private sector was encouraged and given generous incentives such as tax holidays and free imports of power equipment. Under the "Policy Framework and Package of Incentives for Private Generation Projects in Pakistan" (1994), incentives such as internationally competitive rates for the purchase of electricity, reduction in local currency investment requirements, tax cuts, import subsidies and foreign exchange risk insurance were provided. The government also launched a medium-term reform programme that involved breaking up the Power Wing into twelve autonomous entities for power generation, transmission and distribution. Moreover, the Water and Power Development Authority of Pakistan has prepared a Hydropower Development Plan Vision 2025, which suggested a consolidated list of potential projects to be implemented in the short, medium and long-term.

The advantages of cross-border exchange of energy are well established and can be seen in a variety of groupings such as Nord Pool (Norway, Sweden, Finland and Denmark) and the South African Power Pool (South Africa, Lesotho, Mozambique, Namibia, Malawi, Zambia and Zimbabwe). Cross-border energy trade could lead to effective utilisation of natural resources, increase in supply reliability, savings in capital and operating costs, optimal use of generating capacity and mutual support during contingencies. In the context of India and Pakistan, it would act as an important confidence building measure through the participation of multiple stakeholders and would substantially promote market integration in energy related goods and services. The increasing realisation of the importance of such energy exchange agreements among South Asian economies is evident from discussions on the issue at important summits such as the Islamabad Declaration 2004 and the Male Summit, 2011. Sensitization and preparations for energy co-operation have been undertaken in the past decade, including co-operation among the technical and professional public sector organisations such as Petrobangla, Power Grid and Power Trading Corporations of India and the electricity authorities of Nepal, Sri Lanka and Pakistan. International organisations have also played an active part by setting up training programmes and capacity building projects across SAARC countries. Moreover, studies by numerous South Asian institutes have brought forth suggestions and policy recommendations from academics. Against the backdrop of these recent developments, the case for co-operation in energy has been strongly made out.

In India, barring the Eastern region, all other power grids face perennial energy shortages (Northern, Western, North Eastern and Southern) – with the Northern and Southern regions facing maximum demand-supply gaps. In order to meet demand, capacity addition of 10,000-15,000 MW is required for the next 10 years. The concentration of power demand will come from the Northern and Western regions, according to the projections of the Central Electrical Authority, which opens up possibilities for power import from neighbouring countries. With respect to Pakistan, the projections of the energy wing show that Pakistan would require another 20,000 MW by the year 2020. To overcome this power deficit, the Government of Pakistan has announced a power policy whose thrust is to encourage private investment to increase installed capacity to 48,284 MW by 2025.

In India, the suppliers of bulk power are central generating stations, independent power producers, mega power projects, vertically integrated utilities/state transmission utilities and PTC India Limited. On the other hand, the power sector in Pakistan depends on hydel and thermal power as fundamental energy sources; although the share of hydel power generation has declined significantly.

The variation in the installed capacities of power utilities in India and Pakistan reflect the potential of both sectors based on their natural endowments – especially in the sphere of hydropower. In India, the Eastern region, despite its large hydro power potential, continues to be a laggard, while even hill states such as Jammu and Himachal Pradesh contribute a meagre 2.4 per cent of the total installed capacity. Similarly, in Pakistan too, of the total 40,000 MW of identified hydel potential, only 6481 MW has been harnessed so far.

Given the burgeoning power deficits, a possible way forward could be limited exchange of power between India and Pakistan through bilateral power trade, pool based exchange and wheeling facility. Cross-border power trade in the bilateral mode already takes place widely between India and Bhutan through Power Purchase Agreements for three projects – Chuka, Kurichu and Tala. Surplus power from Bhutan is exported to West Bengal, Orissa and the North East. Three landmark projects of energy co-operation with Bangladesh have also begun - a giant leap for longstanding negotiations between the two countries.

In case of the pool based mechanism, surplus power from individual plants in the participating countries is pooled, and then transported to deficit areas through a co-ordinated exchange mechanism. The launch of a Sub-Regional Power Trading Corporation in the India Pakistan sub-region would be highly beneficial, providing market feedback to

individual power producers as well as power consumers. Alternatively, it would also be advantageous for Pakistan to import power from Nepal and Bhutan. Here India could play a critical role in providing an exclusive wheeling facility, which could also be used by Pakistan to buy power from anywhere in India on a commercial basis as well. Similarly, an opportunity exists for Pakistan to import electricity from Central Asia/Iran via Afghanistan and provide transit to India and other SAARC countries.

Negotiations on energy co-operation between India and Pakistan broke down in 1999 owing to disagreement on prices, but due to the high potential and Pakistan's severe power shortage, talks have commenced again after nearly 15 years. A group of experts on energy met thrice and the fifth round of secretary level talks on commercial and economic co-operation between India and Pakistan took place in April 2011. There already exists a complete network for transmission on both sides and connecting them would take very little time. However, the key issues to be settled before the cross-border flows would be cost of transmission lines and the sharing mechanism, power tariff, payment mechanism and most importantly, power supply sustainability. Keeping these in mind, the paper recommends proactive actions on the part of both countries. These include the provision of policy and institutional frameworks, development of the grid interconnection infrastructure, cross-border investment with a project-based approach and an institutional mechanism to decide on the electricity trade tariff.