India-Pakistan Trade Newsletter

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India-Pakistan Trade: Part of a Larger Scenario for Change in South Asia

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As Prime Minister Narendra Modi begins his tenure in New Delhi, the economic and security stakes in India's neighbourhood could not be higher. A permanent state of hostility with Pakistan has cost both countries dearly. According to a recent report[1] authored by Mohan Guruswamy and myself for the Atlantic Council, that examined the opportunity cost of this conflict, India and Pakistan could well add some 1.5 percent to their GDP growth if they were to end their hostility. And it is not just trade; Prime Minister Modi and his Pakistani counterpart Prime Minister Nawaz Sharif have a historic opportunity to alter the trajectory of relations in the sub-continent, while improving the lives of their populations. This means they must be prepared to weigh the options before them to remove the ingrained distrust that currently pervades thinking on both sides of their common border. And they will need to fend off domestic opponents of a rapprochement.

Both have made promises to improve their economies. That is a tall order. Mr. Modi will need to create some 15 million new jobs a year for a population whose median age is 26 years. Sharif needs to create some 3 million jobs a year for a population whose median age is 22 years. A focus on economics, youth and urban cohort were the key to their respective victories. But older fears and suspicions persist on both sides of the border.

Pakistan fears a hegemonic India outstripping it with its enormous military and economic might. Indeed, the United States National Intelligence Council has a scenario in which India's economy will be 16 times the size of Pakistan's by 2030, making it difficult for Pakistan to create some sort of equilibrium against its huge neighbour to the East. India fears a Pakistan reverting to asymmetric warfare, fomenting trouble outside its borders. Both countries dread the prospect of an unstable Afghanistan after the withdrawal of foreign troops and perhaps foreign assistance, and the possibility of a proxy war between them for influence in that strategically located state. The elephant in the room for both is the result of the trials of persons associated with the Mumbai attack of 2009. Pakistan is said to have tried to accelerate those trials. If that succeeds, it may give a boost to improving relations with Prime Minister Modi's India in its early days in power. If not, things may slow down yet again.

Mr. Modi and Mr. Sharif have an opportunity to prepare the economic ground for change, domestically first, and use it as a springboard for regional integration. Mr. Modi is bringing

[1] The report is titled 'India and Pakistan: The Opportunity Cost of Conflict'.

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in new blood in the policymaking circle. Mr. Sharif has yet to do that. But he has the potential to create a circle of expertise around the various topics that divide India and Pakistan so that the exchanges can be better informed and there are no recriminations, as is often the case when one side or the other considers that it has "lost" something in the bargain.

As former Secretary of State George Shultz wrote in his introduction to our Atlantic Council study:

"Here we have two countries full of competent people and many complementary capabilities. In this setting, trade should be booming, much to the benefit of people in both countries. Instead, trade is a mere trickle."

Indeed, US$2 billion a year trade does not do much for the people of either side. How that can be changed to expand trade to a "natural" level of US$40-100 billion a year is not rocket science. Both sides know what they have to do. But removing the deep legacy of suspicion will require bold actions by the new leaders in India and Pakistan. Rather than try to unravel this Gordian knot, they will have to cut through it.

The obstacles are huge and real. Both countries have to act in their own national interest. One nation's gain must not produce a loss for the other. The transitional period during which trade would be opened up will require protection for those industries and sectors that will suffer heavily due to competition from the neighbour. In Pakistan, the agriculturists, pharmaceutical industry, and parts of the automobile sector stand to lose in the short run. India may see the banking and finance sector vulnerable to more agile competitors from Pakistan. But the common consumer could benefit overall. No one is speaking for the consumer, as the parrying and thrusting goes on in the corridors of power.

The biggest obstacle to the creation of better understanding remains bureaucratic inertia. Regulations and controls weigh heavily on commerce between the two countries. Non-tariff barriers (NTBs) abound. Pakistan maintains that these NTBs undercut the most favoured nation status that India bestowed on Pakistan in 1996. India points to the slow speed at which the Pakistan Peoples' Party government under President Asif Ali Zardari and his various Prime Ministers and now, the Sharif government, has operated in extending a similar status to India. The causes have been variously described as the reluctance of the Pakistan military to move too fast on just trade when other issues also demand negotiation, and domestic pressure groups especially from the agricultural sector in the Punjab. Potentially, military-owned cement and transport enterprises could gain from cross border trade, allowing them to provide for the welfare of retired servicemen in Pakistan. But the military may not want Pakistan to allow trade to overshadow other security-related issues – Siachen, Kashmir and Sir Creek. How Mr. Sharif assuages the military's concerns and brings them on board on a wider and deeper reconciliation with India will be a test of statesmanship.

The automobile sector in Pakistan is not unified in opposing non-discriminatory access to Indian products. Some automobile importers and assemblers would rather buy the same Japanese cars produced in India at a lower price and sell more of them inside Pakistan. Opportunities also abound in the information technology sector as Pakistan's labour price advantage would allow joint operations for Indian and Pakistani software companies to work together to capture a larger share of the global market, especially at the upper end of the value chain. Together, they could provide competition to China. And local consumers would come out ahead.

On agriculture, there are deep seated concerns on the Pakistan side that Indian subsidies for inputs, including free electricity for farmers, may allow the dumping of Indian products in the Pakistan market. India may wish to assuage those concerns by voluntary export restraints for some time for the markets to equalise. This is potentially a political minefield for both Prime Ministers. Yet, they need to help each other overcome these obstacles.

Within India, Mr. Modi's biggest challenge will be the heavy hand of the bureaucracy. Well-established and cumbersome processes involving multiple ministries in the trade dialogue, some directly and some indirectly, will be hard to dislodge.

With much political power devolving to the states in any case, central ministries will be loath to give up their controls in the few areas where they retain some say. Getting the Ministries of External Affairs, Home Affairs, and Commerce to work together effectively and efficiently on cross-border issues and on visa simplification is a tall order. Having a National Security Adviser who straddles the worlds of the MEA and the MHA may help. And a fresh face from outside the Delhi circuit as the Foreign Policy Adviser will help too. The advantage that Mr. Modi has over his predecessor government is that he brings fresh and relatively younger minds to the task. By choosing a young commerce minister who has been part of the BJP's inner circle, he is likely to inject some energy into this dialogue. Perhaps that will be the key to changing the old order. May be Mr. Sharif can learn from that so he does not rely solely on his 1998 vintage kitchen cabinet and widens his circle of advisers. Kudos to him though for persevering in his quest to alter the dialectic on India-Pakistan dialogue and trade. He has been unwavering in that quest, despite critiques from all sides.

Both Prime Ministers will need a lot of help from their business communities, who can push them into faster action and help educate public opinion on the pros and cons of the trade dialogues taking place these days. The important thing is that talks are proceeding. Better than trading fire across disputed borders. Nothing to date has given us ground for irrational exuberance on this front. But the trajectory of talks is positive and for those who favour greater trade and better understanding in South Asia, that may be enough basis for hope.

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India-Pakistan Trade Normalization Crucial for South Asian Integration

Nisha Taneja

Sanjana Joshi

Isha Dayal

In a bold and unprecedented move, Prime Minister-elect Narendra Modi invited the heads of governments of members of the South Asian Association for Regional Cooperation (SAARC) to attend his swearing in ceremony. This is the first time that India has extended such an invitation for what is essentially a domestic event.

In a region where symbolism matters a great deal, this move not only will go a long way in allaying the fears and perceptions of our neighbours but has also deftly signaled that a South Asia that grows and prospers together is the key to India's emergence as a world power and that this would be a priority for the new government. In a sense this lays down the beginnings of a new foreign policy that would define India's role globally in which the neighbourhood would play a key role.

Indeed Prime Minister Modi has a tremendous opportunity to extend his development discourse to India's neighborhood policy and take the lead in regional economic integration. What has been largely ignored is that his emphasis on good governance and development elicits a great deal of admiration across the region. Economic growth and the democratic transition in South Asia have fuelled people's aspirations and many say privately that they wish their political establishments also gave similar primacy to development issues.

South Asia, home to 1.6 billion people is one of the least integrated regions of the world. Intra-regional trade accounts for a mere 5 percent compared to ASEAN's 25 percent and the European Union's 59 percent. Even though the region has experienced high growth rates in recent years and the member countries are individually getting more integrated with the global economy, economic integration within the region remains a far cry.

Several attempts have been made to integrate the region through trade. Particularly with regard to lowering of tariffs, a great deal has been accomplished in recent years. However, the gains from tariff liberalization remain untapped. For example, in 2012, SAARC's intra-regional exports were 5.76 percent and imports 3.4 percent whereas the corresponding figures for ASEAN were 25.96 percent and 23.50 percent[1], respectively. Two key areas that could be game changers are seamless movement of goods and greater mobility of people for business purposes.

With regard to the first issue, a number of steps need to be undertaken in order to facilitate smoother flow of goods across national borders in the South Asian region. Both, soft and hard infrastructure is required to provide for seamless transport connectivity among regional partners - be it the protocols and policies or the physical infrastructure.

Even though all South Asian countries, except Sri-Lanka, share common land borders, the soft infrastructure at land ports and land transport policies are in urgent need of amendment. The primary constraint is a restriction on movement of trucks in each other's territory and a ban on containerized movement of goods. To facilitate seamless transportation a key prerequisite for member counties would be to become signatories to international conventions. With the objective of harmonizing and simplifying the policies and protocols pertaining to international road transport, a Convention on International Transport of Goods - TIR Carnet (TIR[2] Convention) - was introduced in 1975 by the United Nations Economic Commission for Europe (UNECE) in Geneva. Countries party to the convention abide by a liberal customs transit system that allows movement of goods in sealed vehicles or containers (containerized transport), and freedom from excessive and time-consuming checks at border crossings under full customs security and guarantee. The TIR carnet extends to rail and sea modes of transport as well, unless at least a part of the journey is conducted via road.

[1] Data source: United Nations Conference on Trade and Development (UNCTAD) Statistics Division.
[2] TIR is an acronym for 'Transports Internationaux Routiers'.

However, except for Afghanistan[3], none of the other SAARC member countries have ratified the convention leading to cumbersome and time consuming formalities associated with cross-country movement of goods by road. A move towards ratifying such international conventions and protocols which permit seamless transport connectivity across national borders would thus be a very useful initiative towards South Asian integration.

The physical infrastructure for regional trade too is in need of urgent attention. And here the idea of the South Asian Development Bank has been languishing for a long time. The presence of a South Asian Development Bank supported by ODA flows, equity participation of member governments and debt financing instruments (issuance of investment grade bonds) is the way forward for comprehensive and sustainable regional economic development. Further, within this there should be a dedicated infrastructure fund on the lines of the 'ASEAN Infrastructure Fund' (AIF). Formed in September 2011, the AIF is funded by equity from ASEAN member states and the Asian Development Bank, and aims to lend around US$300 million annually to meet the financing needs of infrastructure development projects across ASEAN.

The South Asian region already has the SAARC Development Fund (SDF) with three windows - Social, Economic, and Infrastructure. However, as of now only the social window is operational with US$62 million committed for nine social window projects as of end-2013.

The movement of people in the region for business purposes also remains deeply restrictive. The SAARC Visa Exemption Scheme (SVES) launched in 1992 allows 24 categories of people including dignitaries, judges of higher courts, parliamentarians, senior officials, business persons, journalists, and sportspersons exemption from requirement of visa within the region. Presently, under the scheme 200 such stickers across all categories are issued in one calendar year. This means that business persons have limited access to this scheme and moreover in 2012 the validity period has been reduced to 30 to 90 days from one year. At the 5th SAARC Business Leaders Conference in January 2014, India had supported the enhancement of the SVES stickers to 500, but, there has been no further progress in this direction.

What the region needs is a scheme like the Asia Pacific Economic Community's 'APEC Business Travel Card' (ABTC) that allows business travelers pre-cleared, facilitated short-term entry to participating member economies. The ABTC removes the need to individually apply for visas or entry permits, saving valuable time, and allows multiple entries into participating economies during the three years the card is valid. Card holders also benefit from faster immigration processing on arrival via access to fast-track entry and exit through special APEC lanes at major airports in participating economies.

The ABTC was developed in response to the need for business people to gain streamlined entry to the economies of the Asia-Pacific region to explore new business opportunities, attend meetings and conduct trade and investment activities. The ABTC scheme is managed by the APEC Business Mobility Group (BMG), one of the sub-fora working groups of the APEC Committee on Trade and Investment (CTI). It is made up of government representatives from the 21 member economies of APEC. These representatives are from government departments responsible for immigration and consular affairs.

The challenges and even solutions for South Asian regional economic integration have been debated ad nauseam. What is needed is a determined and concerted political push which seems possible with the new government's focus on South Asia. However, South Asian integration also requires India and Pakistan trade normalization. It is not only an essential building block of this process, but can be the catalyst for regional transformation. With demonstrable progress in bilateral economic engagement, the two countries will generate a more sustainable regional peace dividend and also make regional integration more achievable. Here the tangible step forward would be a speedy grant of Non Discriminatory Market Access (NDMA) by Pakistan to India.

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[3] As on date, Afghanistan is the only SAARC country with which a TIR transit operation can be established.

SAARC Economic Indicators

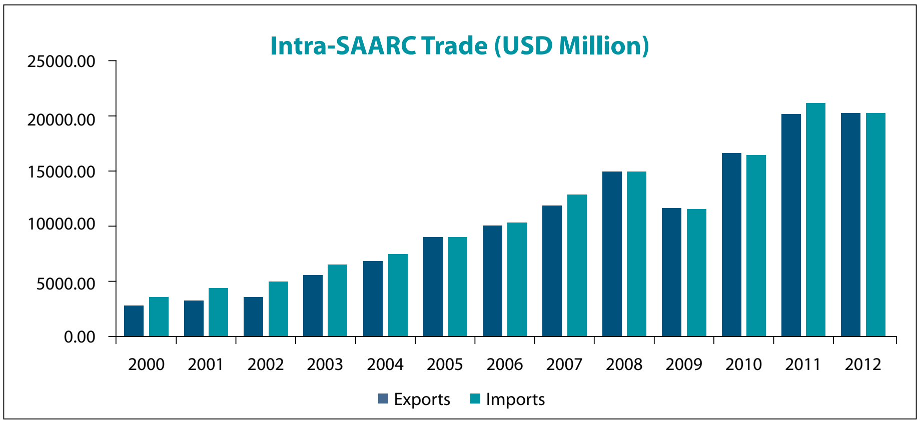
GDP Growth (Annual %)					
S.No.	SAARC Member	2010	2011	2012	Average Growth Rate (2010-12)
1.	Afghanistan	8.43	6.11	14.39	9.64
2.	Bangladesh	6.07	6.71	6.23	6.34
3.	Bhutan	11.68	8.51	9.44	9.88
4.	India	10.26	6.64	4.74	7.21
5.	Nepal	4.82	3.42	4.85	4.36
6.	Pakistan	1.61	2.79	4.02	2.80
7.	Sri Lanka	8.02	8.25	6.41	7.56
8.	Maldives	7.06	7.05	3.42	5.84

Source: *World Development Indicators, World Bank*

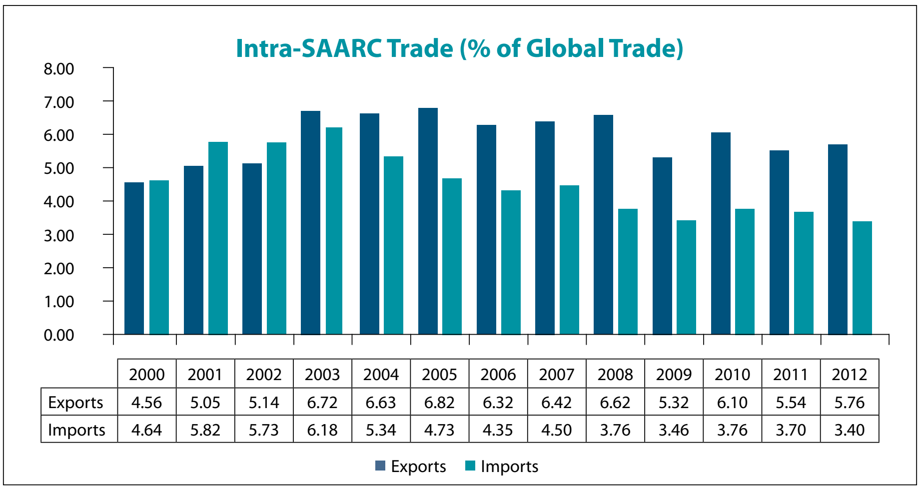
SAARC GDP Growth (Annual %)	2010	2011	2012	Average Growth Rate (2010-12)
	9.13	6.32	4.86	6.77

Source: *World Development Indicators, World Bank; author's calculations*

Intra-SAARC Trade



Source: *UNCTAD Statistics*



	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Exports	4.56	5.05	5.14	6.72	6.63	6.82	6.32	6.42	6.62	5.32	6.10	5.54	5.76
Imports	4.64	5.82	5.73	6.18	5.34	4.73	4.35	4.50	3.76	3.46	3.76	3.70	3.40

Source: *UNCTAD Statistics*

Note: *Exports refer to intra-regional exports as percentage of SAARC global exports; Imports refer to intra-regional imports as percentage of SAARC global imports*

Project Activities

21–22 January 2014, Annual Conference

India Habitat Centre, New Delhi

The 2nd Annual Conference on 'Normalizing India-Pakistan Trade' was organized on 21-22 January 2014 at New Delhi. The Keynote Address was delivered by Dr. G. K. Chadha, *President, South Asian University*. The Chief Guest in the inaugural session was Mr. Rajeev Kher, *Special Secretary, Department of Commerce*, *Ministry of Commerce and Industry, India*. Over the course of the two day conference, special addresses were also delivered by Dr. Ishrat Hussain, *Dean & Director, IBA and Former Governor State Bank of Pakistan* and Mr. Sharat Sabharwal, *Former Indian High Commissioner to Pakistan*. Ms. Sujatha Singh, *Foreign Secretary, India*, delivered the valedictory address at the conference.

The conference brought together scholars, industry representatives and policy-makers to reflect on the trade normalization process and discuss the opportunities and challenges for enhancing trade between the two countries. A number of research studies are being conducted under the aegis of this project, encompassing trade in automobile, pharmaceutical, agriculture, and energy sectors, as well as non-tariff barriers; the findings of which were presented and discussed at the conference.

The notable participants from Pakistan included Ishrat Hussain, *Dean & Director, IBA and Former Governor State Bank of Pakistan;* Zafar Mahmood, *Chairman, Punjab Public Service Commission and Former Commerce Secretary;* Ijaz Nabi, *Country Director IGC and Faculty LUMS;* Syed Turab Hussain, *Associate Professor, Dept of Economics, LUMS;* Abid Suleri, *Executive Director, Sustainable Development Policy Institute;* Manzoor Ahmad, *Regional Trade Advisor, USAID Pakistan;* Suhail P. Ahmed, *Founder Chairman, Pakistan Association of Automotive Parts and Accessories Manufacturers;* Syed Yawar Ali, *Chairman Nestle Pakistan Ltd and Member Pakistan Business Council;* and Tariq Bucha, *President, Farmer's Association, Pakistan.*

Summary of proceedings of the annual conference is available at: *http://indiapakistantrade.org/pdf/2nd_Annual%20 ConferenceIndia-Pakistan.pdf*

The report on the first *'India-Pakistan: Trade Perception Survey',* undertaken by ICRIER, was released at the conference. It is available on the project web portal and can be accessed at: *http://indiapakistantrade.org/pdf/TPS-India-Pakistan.pdf*

The project web portal for India-Pakistan trade information is:

www.indiapakistantrade.org

The website provides regular updates on current policy developments, macroeconomic data and project's research activities.

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