
India-Pakistan
Economic Cooperation:
Implications for
Regional Integration in
South Asia

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While the technical analysis and results presented here are finalised, this version of the report has not been copyedited.

India-Pakistan Economic Cooperation: Implications for Regional Integration in South Asia

Selim Raihan* and Prabir De**

Abstract

This study examines trade potential between India and Pakistan in greater details and does a mapping of major trade barriers affecting the bilateral as well as regional trade in South Asia. It also makes an attempt to quantify the gains for India and Pakistan and the South Asia region from the India-Pakistan MFN scenario. The CGE modeling of this study shows that Pakistan's MFN to India would generate larger benefits if it is supported by improved connectivity and trade facilitation. The net economic impacts of SAFTA along with trade facilitation are beneficial to both Pakistan and India, and eventually would lead to stronger economic growth for the entire South Asian region. With Pakistan's MFN status to India, the full implementation of SAFTA is therefore not beyond our reach. Both the countries should therefore go beyond MFN and embrace to a second generation comprehensive agreement that would open the door to other regional cooperation initiatives. India and Pakistan have come a long way to rebuild their economic and political relations. A liberalised India-Pakistan trade and investment regime would strengthen the economic relationship and regional integration. A stronger India-Pakistan relation would help realise a prosperous and peaceful South Asia.

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1. Introduction

The past three years have seen major changes in trade and investment relations between India and Pakistan marking a new phase in India-Pakistan bilateral economic cooperation. Since the revival of trade talks in 2011, the two neighbouring countries have come closer with a vision to enhance peace and stability in the South Asia region. There have been several initiatives taken by both these countries for strengthening bilateral relations, of which Pakistan's decision to offer the most favored nation (MFN) status to India is a remarkable one.

After partition in 1947, India accounted for about 70 percent of Pakistan's official trade. However, discordant political relations brought halt to the bilateral official trade between the two countries. During 1965 and 1973, bilateral trade flows brought to nil. In 1971, India and Pakistan signed first trade agreement, which did not last long. Pakistan introduced first positive list in 1989 (4 products originally), and then kept the number increasing almost every year. Soon after establishment of the WTO in 1995, India granted the MFN status to Pakistan. From end of 1990s till mid of the last decade, political issues affected the bilateral economic relations. As soon as the leaders of the two countries felt the need for stronger bilateral economic relations, they came forward with measures to enhance economic exchanges between them. Musharraf-Singh "Composite Dialogue" in 2004 is the example, where "trade" alone formed 4 treaties between the two countries. Later, Pakistan announced a positive list of 757 items in 2004, and rail and air routes were reopened in the same year. Pakistan announced another positive list of 1075 items in 2006, and more trade incentives came in between such as cross-border truck movement, etc. Bilateral trade declined sharply in the aftermath of the global financial crisis. Pakistan had to announce another positive list of 1934 items in 2009 with an aim to bring back the growth momentum in bilateral trade.¹ There was no look back thereafter. As the region rebounds from the global financial crisis, India and Pakistan agree to deepen their bilateral relations leaving aside their political baggage. Pakistan has decided to extend the MFN status to India in 2012, and replaced the restricted positive list with a negative list in February 2012. India reciprocated it by allowing FDI from Pakistan. There are many such initiatives initiated by both the countries, particularly in recent years. The two countries have agreed to simplify customs procedures, facilitate the process of goods certification, and visa liberalisation. Undoubtedly, the environment for bilateral trade has greatly improved.

India and Pakistan aim at reducing the extent of barriers over various aspects of bilateral trade and investment. In particular, three areas of cooperation have been emerging from the past secretarial level meetings between the two countries: (i) increased access to each other's markets in goods and services through trade liberalisation including removal of NTBs, (ii) strengthening trade facilitation including improvement in physical connectivity, and (iii) allowing investments to flow in each other countries. Cooperation in each of these areas can potentially result in significant economic and social benefits for both India and Pakistan. Also, this will likely to have important implications for an extended and intensive regional integration in South Asia, given the fact that much of the potentials of the gains from an integrated South Asia have been deemed to remain unrealised because of the political issues between India and Pakistan. A set of past studies suggest deeper economic relations between

¹ Interestingly, the cumulative list of tradable items under the Pakistan's positive list increased a modest rise from 600 in 2000 to 4376 in 2009.

India and Pakistan would not only benefit Pakistan or India alone but also the entire South Asian region in raising its trade competitiveness, growth and quality of life of the region's population.² Undoubtedly, improved bilateral economic relations would improve South Asia's footprint in the world economy. We should also keep in mind that protracted political issues will continue to hamper the normalisation of relations into the future.

Against this backdrop, this study presents a comprehensive overview of the trade relations between India and Pakistan including trade barriers, analyses the modalities of cooperation, and assesses their potential economic benefits to both countries with a particular emphasis on Pakistan and the South Asian region. It also makes an attempt to quantify the gains for India and Pakistan and the South Asian region from the MFN scenario..

The rest part of the paper is organised as follows. Section 2 presents stylised facts on India – Pakistan trade and the barriers to trade. Competitiveness and complementarities between India and Pakistan are then discussed in Section 3. Section 4 analyses the impact of India – Pakistan MFN on trade flows and regional implications. Section 5 then discusses the opportunities in FDI inflows between the two countries and the measures those to be undertaken in order to strengthen such FDI inflows. Policy recommendations are briefed in Section 6, followed by concluding remarks in Section 7.

2. Bilateral Trade – Trends and Bottlenecks

South Asia remains one of the least integrated regions in the world. Pakistan and India account for almost 92 percent of South Asia's GDP, 85 percent of South Asia's population, and 80 percent of South Asia's surface area, whereas only 20 percent of the regional trade is India-Pakistan trade.³ South Asia's two largest economies barely trade with each other (Figure 1), whereas they share 3,323 km of land border that demarcates the Indian states of Punjab, Rajasthan and Gujarat from the Pakistani provinces of Punjab and Sindh. In addition to the Attari-Wagah land border, which is the major road and rail crossing between India and Pakistan, three more land routes, namely, Khokrapar-Munabao, Muzaffrabad-Srinagar, and Poonch-Rawalakot, have been used for bilateral trade exchange between the two countries. Three land customs stations handle the overland trade between the two countries. India and Pakistan also have one direct sea route (Mumbai-Karachi) and three air routes (Delhi-Lahore, Delhi – Karachi, and Mumbai – Karachi). Needless to mention, restrictions imposed by the two countries on trade along border have opened many indirect trade routes between the two neighbours, some of which like Mumbai-Dubai-Karachi and Mumbai-Dubai-Bandar Abbas-Afghanistan-Pakistan act as major trade axis between the two countries.

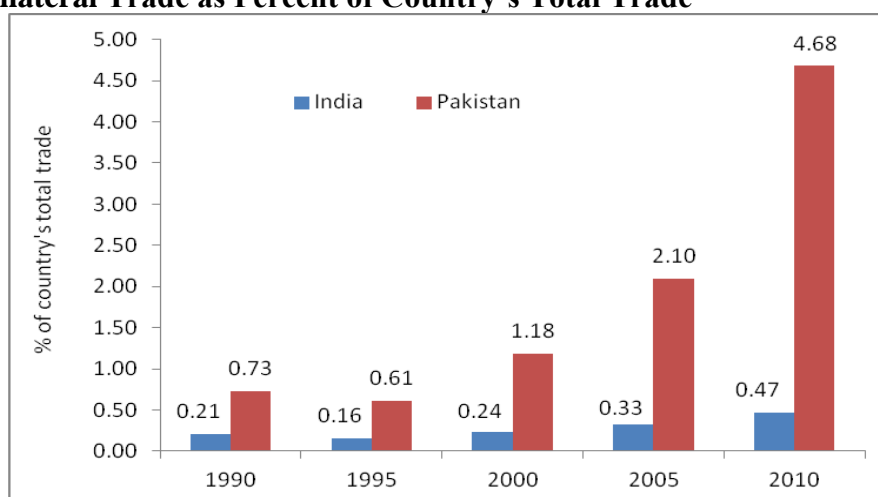
Despite the fact that the trade between the two countries increased over the years, India's trade with Pakistan remained negligible. By 2010, trade with Pakistan accounted for less than half a percent of India's total trade, whereas Pakistan's trade with India was 4.7 percent of her total trade. Except for first agreement, talks always led to rising trade flows; however, trade was halted largely by political disputes. In the past, both India and Pakistan paid minimal attention to trade relations and regional integration in South Asia, as South Asia was not their major trade destination. On top, India – Pakistan political tensions and conflicts

² For a general discussion of the advantages of closer economic relations between India and Pakistan, refer, for example, World Bank (2007), Panagariya (2007), Kemal et al. (2002), Khan (2011), De et al. (2012), Pasha and Imran (2012), to mention a few.

³ Data refers to the years 2010, sourced from WDI Online Database, the World Bank

continued to impose restrictions on bilateral trade and investment, which led both India and Pakistan to look beyond South Asia. This is one of the major reasons why the initial attempts to create a regional trade bloc through SAFTA did not get the desired momentum. However, the success of SAFTA has also been constrained by the lack of domestic economic reforms in the member countries and the lack of progress in the trade enabling environment in this region.⁴ To a great extent, India-Pakistan conflict overshadowed the SAARC agenda for a long time.

Figure 1. Bilateral Trade as Percent of Country's Total Trade



Source: Calculated based on IMF DOTS

India-Pakistan bilateral trade witnessed an upward trend only in the second half of the last decade. Bilateral trade increased sharply, owing much to the India-Pakistan “Composite Dialogue” in 2004. India’s trade with Pakistan trebled in 2010 and reached an all time record of US\$ 2.56 billion (Table 1). India’s export to Pakistan increased much faster than her imports, thereby making India’s trade surplus to increase from less than US\$ 100 million at the beginning of the last decade to US\$ 1.94 billion in the first year of the ongoing decade (Table 1). Therefore, the rising trade between India and Pakistan has also been accompanied by a sharp rise in the bilateral trade deficit in Pakistan.⁵ Nevertheless, compared with their economic strength, trade between India and Pakistan is negligible and much below potential.

Table 1. India’s Trade with Pakistan

	Export	Import	Total Trade	Trade Balance
	(US\$ million)			
1990	43.49	44.86	88.35	-1.37
1995	70.4	37.37	107.77	33.03
2000	163.33	65.05	228.38	98.28
2005	647.19	158.42	805.61	488.77
2010	2252.89	310.44	2563.33	1942.45
CAGR (%)				
1990-1999	9.22	9.88	9.56	
2000-2009	27.45	17.32	25.18	

Source: UNCOMTRADE

⁴ Refer, for example, Ahmed and Ghani (2010), Hussain (2010), to mention a few.

⁵ The widening and surplus trade balance is in favor of India; but it should not be the major concern. Bilateral trade deficit has to be seen in the light of country’s total trade balance.

An analysis by sector reveals that the composition of exports from India to Pakistan was primarily limited to about 14 commodities in 2010-11, which on average accounted for around 78 percent of the total Indian exports to Pakistan (Table 2). These commodities include sugar, raw cotton, synthetic fabrics, tea, petroleum products and chemicals, reflecting India's more diversified export base. Shares of both raw cotton and woven fabrics in India's export to Pakistan increased from almost zero in 2000 to more than 13 percent in 2010, whereas the share of oil-cake and other solid residues declined from about 16 percent to 3 percent during the same period. The composition of official major imports from Pakistan to India has been limited to 18 commodities, namely, fruits and vegetables, wool and products, petroleum products, chemicals, lead, and more recently cement. These products together share about 88 percent of India's total import from Pakistan. In 2010, the sectors with large shares in exports from Pakistan to India were of fruits (19 percent), followed by petroleum products (12 percent), and cement (11 percent) (Table 3). In short, the trade volume between India and Pakistan never expanded the way it would have been in case of normal trade environment. Why? First and foremost is political disturbances. Bilateral trade and commerce were held hostage to resolution of political disputes. The second is protectionism. For years, domestic industry in Pakistan has feared it would be swamped by imports from India. The third is restrictive trade policies in both countries, which is embedded with a variety of trade barriers targeted to each other's market. But even there, the mood appears to have shifted. Expansion of trade will create stronger constituencies for peace in both countries and the entire South Asian region.

Table 2. Composition of India's Major Exports to Pakistan in 2010-11*

Sr. No.	HS Code	Commodity	Exports (2010-11)	
			Value (US\$ million)	Share** (%)
1	1701	cane/beet sugr chmclly pure sucrose in solid	652.31	27.95
2	5201	cotton, not carded or combed	384.76	16.49
3	5407	wovn fbrcs of synthtc filament yarn incl wovn fbrcs obtnd from mtrls of hdg no.5404	233.23	9.99
4	2902	cyclic hydrocarbons	197.17	8.45
5	0713	drid leguminous veg shld w/n skinned/split	59.6	2.55
6	2304	oil-cake and other solid residues whether or not ground or in the form of pellets, resulting from the extraction of soyabean	51.13	2.19
7	4011	new pneumatic tyres, of rubber	42.01	1.80
8	3204	syntc orgnc colrng matr w/n chmclly dfnd	32.92	1.41
9	0904	pepper of the genus piper; dried or crushed or ground fruits of the genus capsicum or of the genus pimenta pepper	29.82	1.28
10	2710	petroleum oils& oils obtnd frm bitmns mnrlthor than crude prpn nes;cntng70% or moreby weight of these oils	28.76	1.23
11	9993	special transactions & commodities not classified according to kind	27.06	1.16
12	3808	insectcds,rdntcds,fngcds,hrcbcs,antsproutngprdetcs & plntgrwth rgltrs-dsinfcntcs etc in pckngs/as artcls (slphr-trtd bnds etc)	25.1	1.08
13	7202	ferro-alloys	24.28	1.04
14	0902	tea	23.25	1.00

*Presents for those having 1% and above share in total exports. **Share in India's total exports to Pakistan

Source: Calculated based on Export-Import Databank

Table 3. Composition of India's Major 15 Imports from Pakistan*

Sr. No	HS Code	Commodity	Imports (2010-11)	
			Value (US\$ million)	Share** (%)
1	0804	dates, figs, pineapples, avocados, guavas, mangoes, and mangosteens, fresh or dried	62.56	18.81
2	2710	petroleum oils & oils obtnd frm bitmns mnrl other than crude prpn nes; cntng 70% or more by weight of these oils	40.98	12.32
3	2523	portland cement almnous cement ("cement fondu") slag cement etc & smlr hydrlic cements w/n clrd/in the form of clinkers	37.00	11.13
4	7801	unwrought lead	20.56	6.18
5	2711	petrlm gases & othr gaseous hydr crbns	15.99	4.81
6	2903	halogenated derivatives of hydrocarbons	12.53	3.77
7	2917	plycrboxylc acds, thr anhydrds, halides, peroxides & peroxyacds, othr halgntd slphntd nitrated or nitrosated derivatives	10.67	3.21
8	5209	wovn fbrcs of cotton, cntng >=85% cotn by wt weighng >200 gm per sqm	10.13	3.05
9	2902	cyclic hydrocarbons	9.47	2.85
10	5101	wool not carded or combed	9.27	2.79
11	2836	carbnts; peroxy carbnts (percarbnts); cmmrclammonium carbonate cntng ammonium carbnts	8.80	2.65
12	7404	copper waste and scrap	6.42	1.93
13	5208	wovn fbrcs of coton cntng >=85% by wt of coton weghng nt more thn 200 g/m2	6.10	1.83
14	3923	artcls for the cnvynce/pckng of goods stoprs lids caps & othr clsr of plstcs	5.93	1.78
15	4107	leather further prepared after tanning or crusting, including parchment-dressed leather, of bovine (including buffalo)	5.69	1.71
16	4104	taned/crust hide & skin of bvne (inclndng buffalo) or equine animal without hair wonsplt but nt further prepared	5.58	1.68
17	0713	drid leguminous veg shld w/n skinned/split	5.58	1.68
18	5205	cotn yrn (othr thn swng thrd) cntng 85% or more by wt of coton nt put up fr retl sale	5.09	1.53

*Presents for those having 1% and above share in total imports. **Share in India's total imports from Pakistan
Source: Calculated based on UNCOMTRADE

Today, Pakistan has 1209 items in the negative list, which were supposed to be phased out by end of 2012, but it did not happen. Appendix 1 shows the sector – wise aggregation of negative list. Out of 8000 items, only 15 percent or 1209 items are placed in the negative list. The remaining 6800 can now be imported from India, while the previous positive list had only 2000 items. This is a significant change whereby 85 percent of tradable goods can be procured from India, compared to 25 percent previously. The SAFTA, which both India and Pakistan have signed, will gradually phase out all tariffs on traded goods with zero tariffs by 2016.

Trade between India and Pakistan has undergone very restrictive trade regimes in the past. Pakistan and India had been amongst the most restrictive trade regimes, but their barriers to trade are different. As mentioned earlier, bilateral trade was made hostage to political conflicts quite often. Also, bilateral trade barriers continued to surge despite the fall in overall trade protections in India and Pakistan. Bilateral barriers to trade are very complex in nature and appeared to be “thick” at the land border. This results to a large informal trade on account of restrictive trade policies and transport bottlenecks, which varies from half a billion to about a billion US\$⁶. At present, a great deal of trade occurs via Dubai, a trade process, which is inefficient and fraught with illegalities effectively functioning as behind-the-border barriers to trade.

The composition of informal trade between the two countries shows that a range of products are avoiding official tariff and non-tariff barriers to reach the third country, reflecting the potential for expanding official trade. SAARC Chamber of Commerce and Industry (SCCI) and several other business groups in Pakistan listed a variety of goods and services traded informally or through third country, which could offer considerable potential for trade between the two countries (SCCI, 2011). Indian products those arrive in Pakistan through this process include tyres, auto components, pharmaceuticals, engineering products, pans, chemicals and some textiles. These industries in India will therefore benefit immediately as a result of the changing environment. Also, the consumers in Pakistan will benefit from reduced prices of these products. As far as Pakistan’s export to India is concerned, cement, fruit and vegetables, cotton, some specialized textiles, and sports items — also currently arriving via Dubai — are expected to experience a rapid boost. And these are only the existing sectors, and there are possibilities of emergence of trade in new products between these two countries in the new environment. It should however be mentioned that India and Pakistan perform poorly with their global peers in terms of improvement in trade logistics. Non-price barriers such costs on account of documentation and transportation surpass the price barrier to trade in South Asia.⁷ Trade becomes uncompetitive when channeled through Dubai due to the rising transportation costs and time, since the normal/MFN trade at the land border between India and Pakistan is still not permitted.⁸ While both the countries have adopted negative list of trade, Pakistan still maintains a positive list for import from India at Attari-Wagah land border, which is inconsistent with the GATT principles.

⁶ Refer, Khan et al. (2007)

⁷ Refer, De (2011), for a general discussion on cost of trade in South Asia.

⁸ More in account of Pakistan’s trade with India since Pakistan has a positive list of 137 items which can be imported from India through Wagah-Attari land border.

Table 4. Major Impediments to India – Pakistan Trade

Tariff barriers	Customs duties
	Special additional duties (SAD)
	Countervailing duties
Non-tariff barriers	Stringent visa regimes
	Trade distorting subsidies
	Overland transportation limitation
	Air travel restriction
	Sea transportation restriction
	Transit restriction
	Port of call restriction
	Railway carriage restriction
Finance measures	Cumbersome payment systems
	Restrictive official foreign exchange allocation ¹
	Regulations concerning terms of trade for import payments ²
	Non-acceptance of letter of credit
	High commission of foreign banks offering letter of credit
	Lack of bank branches
Quality control measures	License with no specific ex-ante criteria ³
	License for selected importers
	Sanitary and phytosanitary measures
Technical barriers to trade	Marking requirements
	Labeling requirements
	Testing, inspection and quarantine requirements
	Pre-shipment inspection/certificate acquisition

Notes: Indian firms and individuals are subject to capital account restrictions. 2. If imports of physical capital exceed US\$ 15,000, an international bank must cover the advance remittance through a bank guarantee. 3. A special import license is required to import certain goods.

Sources: De, Raihan and Ghani (2012) based on Taneja (2012), Khan (2011), Husain (2012)

In the bilateral trade between India and Pakistan, the average tariff does not appear to be the major barrier (De et al., 2012).⁹ However, high tariff still exists on some specific goods. For example, India's tariffs are relatively high on imports of textiles and agricultural products from Pakistan.¹⁰ Since both the countries enjoy comparative advantages in textile and clothing, they follow a restrictive strategy. For example, textile and clothing feature prominently in SAFTA's sensitive list. It should also be mentioned that tariff between India and Pakistan has come down much faster than non-tariff barriers in recent past. Despite the fall in average tariffs, trade restrictiveness of both India and Pakistan has been heavily

⁹ Tariff-related measures include tariff and trade defence measures. Non-tariff measures at-the-border include quotas, import bans, technical barriers to trade (TBT), non-tariff barriers (not otherwise specified). Non-tariff measures behind-the-border include consumption subsidies, local content requirements, public procurement, bailout/state aid measures, export subsidies, trade finance support, support to state-owned trading enterprises and state-controlled companies. Others include investment, migration, intellectual property protection and other service sector measures.

¹⁰ India imposes both ad valorem rate and specific duty, whichever is higher, on import of textile and clothing goods. Generally, the specific duties appear to be higher in India and, in some cases, exceed 100 percent, especially on value-added textiles. Compared to specific duty, ad valorem rates are much lower.

triggered by the large volume of NTBs.¹¹ In promoting trade between India and Pakistan, the major stumbling block is the presence of such NTMs (Taneja et al., 2011), and a list of such NTMs is provided in Box 1. Table 4 presents list of impediments to India-Pakistan trade. Deeper cooperation between India and Pakistan can potentially result in significant reductions of these barriers.

Box 1. List of NTMs

- *Payment procedures:* Some Indian banks do not recognize L/Cs from all Pakistani banks and vice versa.
- *Visa regime:* Still very restrictive on both sides. The visa regime is unpredictable, city specific, single-entry and limited to very few days stays.
- *Air travel:* Very limited to a few flights. Capital cities are not connected by direct flights
- *Road and rail travel:* Limited traffic, lack of railway wagons and locomotives, rail wagons carrying goods should return empty.
- *Sea travel:* Ships should touch a third country port (e.g. Dubai or Singapore) before delivering import goods except limited port of call between Karachi in Pakistan and Nava Sheva in India.
- *Services/IT:* Heavy restrictions limit professional exchanges/cooperation.
- *Services/Banking:* Bank branches are not allowed and export/imports should be made through a third country.
- *Standards:* The Bureau of Indian Standards (BIS) requires a certificate for cement, whereas it takes 6 months (3 weeks in theory) to clear certification. Pakistani labs reports for complying with certification requirements for fabrics and garments are often not accepted in India. Finished leather from Pakistan requires an additional certification from the Indian veterinary department.
- *Infrastructure:* A 10-hour window is given to Indian importers to unload/load, Customs clear and reload, but this is hardly accomplished. Warehousing facilities on both sides of the border are inadequate. Behind the border facilities are very poor. For example, a major part of the road linking Attari with Panipat on India's National Highway 1 is narrow.
- *Trade logistics:* Goods move by air, sea, and rail between India and Pakistan. While road routes for trade are non-existent, rail and air connections between the two countries have been erratic. Inter-change between Pakistan and Indian railways takes place only on Sunday. There are restrictions on mode of transport in export goods. For example, cement export to India is allowed only by train, and export large quantities through train is not possible as the frequency of trains running between India and Pakistan is very low. There are large port congestions, high port and demurrage charges, cumbersome paper works, and generally more issues of trade and transport facilitation in Pakistan.
- *Transit:* Although India and Pakistan are signatories of GATT Article V, they do not extend freedom of transit to each other as well as to international traffic in transit.
- *Testing laboratories at border:* Testing laboratories for trade in agriculture, processed food, chemicals, garments, etc. are not available at both sides of the Attari – Wagah border.

Source: Based on De, Raihan and Ghani (2012)

Lackluster performance in easing the trade restrictiveness in India and Pakistan cannot be ignored. Measures that harm commercial interests of trading partners still outnumber measures with beneficial effects. Highly restrictive trade policies and practices, and other

¹¹ India still has significant NTBs. For example, the NTB frequency/trade coverage ratio is as high as 51 percent in India. In literature, we find NTBs, which basically cover non-tariff measures that have protectionist intent such as quotas, tariff-rate quotas, licensing regimes, price bands, and NTMs. NTMs are policy measures, other than ordinary customs tariffs, that can potentially have an economic effect on international trade in goods, changing quantities traded, or prices or both. Some of these measures may constitute non-tariff barriers.

behind-the-border discriminatory policies and measures, significantly constrain official trade between India and Pakistan. For a long time, India-Pakistan trade regime promoted ambiguity, market imperfections and information asymmetries in trade.¹² Some popular anti-trade measures are as follows:

- Only a limited number of items are allowed to be transported via rail/road; there are specific timings for the opening of these routes and in most cases, there are no proper warehousing/storage facilities available. Road network quality is low with little regional road linkages, while rail networks between ports and markets are often missing, putting unnecessary burden on already inadequate road networks. Unavailability of railway wagons and locomotives at the border, fixed time of loading and unloading of goods and inter-change of goods train between the two countries add to high transaction time and cost of trade.
- The imposition and application of standards in India is often perceived as non-tariff barriers by Pakistan. More importantly, information flows on trade related matters between the two countries is particularly weak, thereby generating enormous problems to exporters and importers.
- India and Pakistan still follow restrictive visa regime. Granting city specific visa, visa for a limited number of cities, limited number of entries and for a limited period of stay, requirement of police reporting on arrival and before departure, requirement of exit from the port of entry, lack of criterion for rejection of visa, granting mode-specific visa, disregarding requested date of entry, and delay in granting visa are some of the restrictions known to us.
- Transit of Pakistani goods through India to Bangladesh and Nepal is prohibited. Pakistan also places restrictions on transit trade from India to Afghanistan.
- Mismatch exists between the HS classification of goods. Indian 8-digit HS classification sometimes used on the Pakistani 6-digit classification of items on the positive list, giving customs officials' room to allow entry based on discretion.
- Most bilateral payments are made through the Asian Clearing Union and businessmen in both countries have complained about the inefficiency of this procedure. Since banks are not freely allowed to open branches across the border, this leads to significant delays, especially when letters of credit need to be confirmed, which can take up to a month.
- Redressal mechanisms for grievances do not exist and prevent some mutually beneficial exchanges from taking place.

Both India and Pakistan have notified several NTBs under SAFTA and later under the bilateral trade negotiation. As mentioned in Taneja (2012), some of these NTMs did not pose any barrier, as they were compatible with WTO rules; some NTMs were also applicable to domestic manufacturers in India but were perceived as NTMs by Pakistan (e.g. interstate taxes); and in some cases corrective action had been taken but yet they were notified as NTMs (e.g. jute bags). On the other hand, some NTMs imposed by India were found to be trade restrictive. For example, some of the TBT and SPS measures in India involved cumbersome procedures. Also, the lack transparency in the regulations is blamed (e.g. regulations related to woollen products and other textiles and jute products). The measure related to labelling requirement for processed foods qualifies as a barrier on account of its

¹² Noted in Taneja (2007) and Khan (2011), the India – Pakistan trade regime lacks transparency, creates uncertainties for traders and leads to high transaction costs.

violation of the principle of national treatment.¹³ Lack of information on regulatory regimes (e.g. PRAs) is another NTM. Absence of systems for recognition of standards for products (e.g. textiles for domestic market) is also a NTM faced by traders between India and Pakistan. In order to facilitate the bilateral trade, these are the immediate challenges which need to be addressed through appropriate policy measures.

Another barrier is the use of dual list to bilateral trade by both India and Pakistan, which is inconsistent with the GATT principle. Pakistan has 1209 items under the negative list for trade with India. Contrary to popular belief, these items are not allowed to be traded through land route. For trade through land routes (mainly, Attari-Wagah), Pakistan maintains a positive list of 137 items, most of which belong to commodity groups like vegetables, cotton, and iron & steel. This clearly suggests goods shall have to move through ocean and/or air route despite having land border crossings between the two countries. With ICP in Attari, handling goods through land border may not be cost effective always but certainly faster than ocean routes. Once the infrastructure at land border is improved, India and Pakistan should not impose any restriction on movement of goods through land border.

There are many opportunities in services trade between the two countries. At present, services trade flow between India and Pakistan is negligible. The rise in trade in goods and investment would encourage the flow of trade in services between the two countries, particularly in health, education and financial services.¹⁴ Both the countries should identify the barriers to trade in services in conformity with their GATS and SATIS commitments and obligations.

Finally, India and Pakistan fair poorly with global peers in improvement in logistics. South Asian countries suffer from excessive direct costs and time taken to cross borders and from inefficiency in cross-border transactions, which ultimately affect trade negatively. Trade procedures are lengthy and semi-manual. Trade in the region is constrained by poor condition of infrastructure, congestions, high costs, and lengthy delays.¹⁵ These problems are particularly severe at India-Pakistan border crossings, many of which pose significant barriers to trade.

In what follows barriers to trade between India and Pakistan can be clubbed into three categories: first, tariff barriers (e.g. Pakistan's positive list till February 20, 2012); second, a large volume of non-tariff barriers (e.g. port restrictions imposed by both countries), and third, poor connectivity (e.g. single trading point at Attari-Wagah border takes most of the load). All these add to high transaction costs and time for trading between the two countries. Large trade potential between the two countries can therefore be tapped at removing these barriers. This would also facilitate rise of trade complementarity between the two countries.

¹³ The measure requires imported processed food items to have a shelf life of at least 60 percent of its original shelf life at the time of import. There is no such stipulation for domestic goods.

¹⁴ For example, Indian School of Business (ISB) has joined hands with the Institute of Business Administration (IBA), Karachi to launch executive education programmes in Pakistan

¹⁵ Refer to, for example, Roy and Banerjee (2010)

3. How much is Trade Complementary between India and Pakistan?

Bilateral trade between India and Pakistan would continue to depend on complementarities and other locational factors. The magnitude of competitiveness and complementarity, to a great extent, reflects the possibility of success of a trading agreement – bilateral or otherwise. It has been argued that greater the magnitude of competitiveness between the trading countries the lower is the probability of a bilateral trading arrangement to succeed.¹⁶ Countries with different comparative advantages and therefore greater complementarities, in principle, have more opportunities to trade with each other compared with those with similar comparative advantage profiles. The assessment of trade complementarity is important for the success of policy-driven trade agreement. The results show the trade complementarities are higher for successful arrangements such as the Canada-US Free Trade Area, and lower trade complementarities emerge for unsuccessful arrangements such as Australia – New Zealand Free Trade Area (ANZCERTA). Furthermore, changes in the index over time can help determine whether their trade profiles are becoming more, or less, compatible.

In this study, the magnitude of competitiveness and complementarities at the 6-digit HS trade classification level between India and Pakistan for the years 2005 and 2010 are estimated. The main objective of this exercise is to examine whether there has been a change in the composition of competitiveness and complementarity baskets between the two countries over time, especially given the fact that these two countries, particularly India, have undergone a significant change in their production structures.

Table 5. Revealed Comparative Advantage (RCA) Index

Country	Year	Trade classification	No of products exported	No of products having RCA>1
Pakistan	2005	HS 6 (at H2)	2848	668 (23)
Pakistan	2010		3194	708 (22)
India	2005		4696	1246 (27)
India	2010		4979	1490 (30)

Note: Data in parentheses indicate percent share in total products exported
Source: Calculated based on UNCOMTRADE

Comparative advantage increases country's market access. Are Pakistan and India getting higher market access globally? Answering this question reveals trade expansion opportunities between India and Pakistan. Based on the Ricardian comparative advantage concept, the revealed comparative advantage (RCA) indicates relative advantage or disadvantage of a certain country in a certain class of goods or services as evidenced by trade flows. A comparative advantage is "revealed", if $RCA > 1$. If RCA is less than unity, the country is said to have a comparative disadvantage in the commodity or industry. In other words, RCA index uses the trade pattern to identify the sectors in which an economy has a comparative advantage, by comparing the country of interest's trade profile with the world average.¹⁷

¹⁶ There exists a strong literature on association between competitiveness and trading arrangement. Refer to, for example, Bhagwati and Panagariya (1996).

¹⁷ Refer, Balassa (1965). Mathematically, RCA can be calculated based on following: $\frac{\sum_d X_{isd} / \sum_d X_{sd}}{\sum_w X_{iwd} / \sum_w X_{wd}}$, where s is

the country of interest, d and w are the set of all countries in the world, i is the sector of interest, x is the

RCA indices in Table 5 show an absolute rise in trade comparative advantages in India and Pakistan during 2005 and 2010. In relative terms, 30 percent of Indian exports in 2010 witnessed revealed comparative advantage, increased from 27 percent in 2005, whereas for Pakistan it had fallen marginally to 22 percent in 2010 from 23 percent (Table 6). Except few products, most of them were not exchanged between the two countries despite their comparative advantages. Undoubtedly, India and Pakistan have not been able to harness their true trade potentials.

Table 6. Export Similarity Index (%)

Trade classification	Trade partner	2005	2010
HS 6 (at H2)	India - Pakistan	21.027	22.496
HS 6 (at H3)	India - Pakistan		23.158

Source: Calculated based on UNCOMTRADE

The RCA scores also show that the competitive trade basket has expanded overtime for India and Pakistan. This indicates to not only the potential of rise in total trade but also to the products in which the countries can increase their bilateral trade. For example, competitiveness has increased substantially in textile and clothing, dyes, pharmaceuticals, yarns, etc. However, whether the competitive edge of a country leads to higher bilateral exports of certain products also depends on whether the partner country imports these products or not. Therefore, it is important to examine the complementarities between India and Pakistan.

To what extent are India and Pakistan competitors in the world market? Do they show any complementarities in trade? Answering these questions provides an idea about trade prospects between them. At first, the export similarity index (ESI) for the two economies at a disaggregated level is constructed.¹⁸ Export similarity index is designed to measure the degree of similarity between the export profiles of two economies. The more similar the export profiles are, the more likely that the economies are competitors in global markets. High similarity indices may also indicate limited potential for intra-industry trade with a regional trading arrangement. It takes a value between 0 and 100 percent. A value of zero indicates no overlap in the export profiles (the countries are not competitors), a value of 100 indicates perfect overlap. The results in Table 6 suggest export profiles of these two economies are not much similar. In large part of this reflects the major shift by India into the exports of high skilled and technology intensity categories, a move is yet to be matched by Pakistan (Table 7). Today, 1/4th of India's global exports is contributed by manufacturers having medium to high skill and technology intensity, whereas almost 2/3rd of Pakistan's global exports come from labour-intensive and resource-based manufactures. Trade complementarity between the two countries may be seen in this perspective.

commodity export flow and X is the total export flow. The numerator is the share of good i in the exports of country s , while the denominator is the share of good i in the exports of the world.

¹⁸ ESI can be calculated based on following formula: $\sum_i \min \left(\frac{\sum_w x_{isw}}{\sum_w X_{sw}}, \frac{\sum_w x_{idw}}{\sum_w X_{dw}} \right) \times 100$, where d and s are

the countries of interest, w is the set of all countries in the world, i is the set of industries, x is the commodity export flow, and X is the total export flow. In words, the smaller of the sectoral export shares (as a percentage) in each product category are taken and added together.

Table 7. Structural Change in Merchandise Trade
(Share in country's world exports)

	Pakistan			
	1995	2000	2005	2010
Labour-intensive and resource-based manufactures	79.18	78.74	73.15	62.03
Manufactures with low skill and technology intensity	0.41	0.66	1.39	1.84
Manufactures with medium skill and technology intensity	0.53	0.98	1.79	2.39
Manufactures with high skill and technology intensity	2.08	3.17	4.80	5.18
	India			
	1995	2000	2005	2010
Labour-intensive and resource-based manufactures	32.90	32.74	21.45	15.09
Manufactures with low skill and technology intensity	6.16	6.77	9.29	9.88
Manufactures with medium skill and technology intensity	6.59	6.67	9.68	9.90
Manufactures with high skill and technology intensity	9.97	11.87	12.90	13.84

Source: Calculated based on UNCTAD Stat

In general, the trade complementarity index (TCI) measures the degree to which the export pattern of one country matches the import pattern of another.¹⁹ An increasing tendency of the index scores between two countries also provides some indication of the likelihood of their further integration. TCI is a type of overlap index. A high degree of complementarity is assumed to indicate more favorable prospects for a successful trade arrangement. Changes over time may indicate whether the trade profiles are becoming more or less compatible. TCI takes a value between 0 and 100, with zero indicating no overlap and 100 indicating a perfect match in the import/export pattern. TCI trends in Figure 2 indicate that both the countries have witnessed a rise in trade complementarity during 2003 and 2010.²⁰ However, as correctly noted in Lopez-Calix (2012), major gains would come from diversifying exports since a “Complementarity Index” as little as 24 percent between Pakistan’s exports and India’s imports shows clearly that opportunities for Pakistan are not large at the “intensive margin” (export more of the same to new Indian markets).²¹ Hence, developing exports at the

¹⁹ TCI can be calculated based on following formula:
$$\left[1 - \left(\sum_i \left| \frac{\sum_w m_{iwd}}{\sum_w M_{wd}} - \frac{\sum_w x_{isw}}{\sum_w X_{sw}} \right| \right) \div 2 \right] \times 100$$
, where d

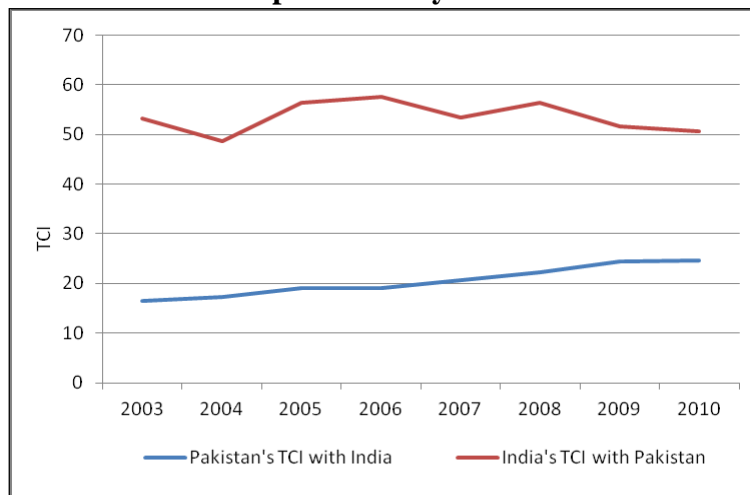
is the importing country of interest, s is the exporting country of interest, w is the set of all countries in the world, i is the set of industries, x is the commodity export flow, X is the total export flow, m the commodity import flow, and M the total import flow.

²⁰ The calculated trade complementarity index (TCI) at the disaggregated level (6-digit HS) for the years 2005 and 2010 (see Appendix 2) suggests a mixed result. Pakistan had a higher trade complementarity than that of India for the years 2005 and 2010.

²¹ Hummels-Klenow (Products) intensive margin refers to the share of country A's exports in world export of only those goods that Country A exports, whereas Hummels-Klenow (Products) extensive margin refers to the share of world export only in goods that country A exports in total world exports of all goods. Pakistan's

“extensive margin” (diversifying the exports basket to India) is fundamental to tap bigger benefits from accessing this large and growing neighboring market. In short, it can be said that increase in trade competitiveness of India and Pakistan has been accompanied by a rise in trade complementarities. However, almost 90 percent of the goods on the Pakistan’s negative list belong to manufacturing items on which India has gained competitiveness (e.g. automobile, iron and steel, etc.). Therefore, Pakistan would lose welfare gains by trading with India if this negative list is continued to be in operation.

Figure 2. Trends in Complementarity between India and Pakistan

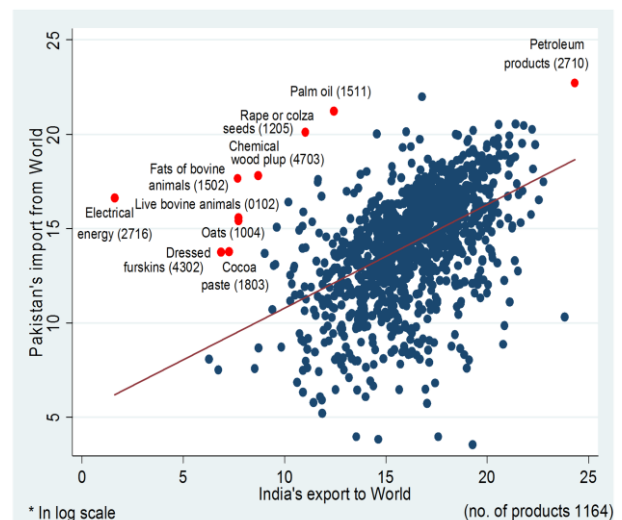
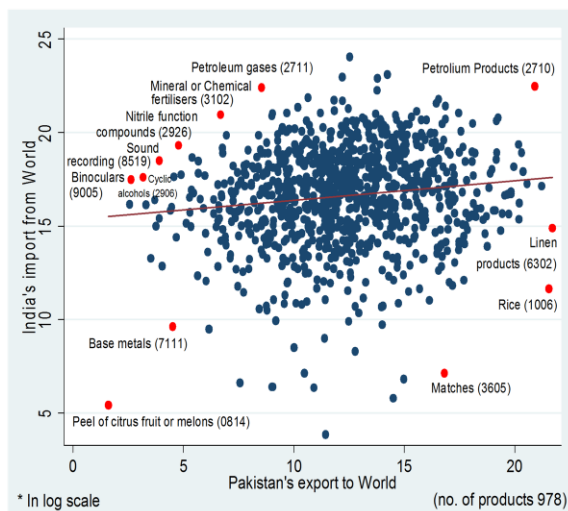


Source: Calculated based on UNCOMTRADE at HS 6

Figure 3. Potential Trade Sectors

(a) Pakistan’s Export

(b) India’s Export



intensive margin (products) is found to be only 0.17 percent in 2010 at HS 4 digit (at H3) trade classification, whereas the same for India is 1.57 percent (calculated based on WITS).

Improving trade complementarities would thus hold promise for encouraging intra-industry trade across borders. Apparently, potential of intra-industry trade between the two countries is not limited to a few products (Figure 3). To examine whether the countries are at different stages of production within an industry, which might further strengthen the argument for rising potential of bilateral (and also intraregional trade), intra-industry trade (IIT) index is estimated and the intensity of intra-industry trade at disaggregated (6-digit HS) level is assessed. Intra-industry trade occurs when a country simultaneously imports and exports similar types of products within the same ‘industry’ or ‘sector’. There are two types of IITs: horizontal IIT and vertical IIT (Greenaway et al., 1995). Horizontal IIT refers to the simultaneous exports and imports of goods classified in the same sector and at the same stage of processing. This is usually based on product differentiation. Vertical IIT refers to the simultaneous exports and imports of goods classified in the same sector but at different stages of processing. This is normally based on the ‘fragmentation’ of the production process into different stages, each performed at different locations by taking advantage of the local conditions. It is also discussed widely in the literature that the IIT is a measure of the degree to which trade in a particular sector represents IIT (based on scale economies and/or market structure).²² By engaging in IIT, a country can reduce the number of similar goods it produces and benefit from scale economies. Higher IIT ratios suggest that these sources of gains are being exploited. The IIT index measures the degree of overlap between imports and exports in the same commodity category, with a value of 1 indicating pure intra-industry trade and a value of 0 indicating pure inter-industry trade.²³

Table 8. Intra-Industry Trade (IIT), IIT > 0.50

	Trade classification: HS6 at H2				Trade classification: HS6 at H3	
	2005	2005	2010	2010	2010	2010
	Global	Bilateral Common	Global	Bilateral Common	Global	Bilateral Common
India	1533	885	1421	965	1438	955
Pakistan	418	413	428	413	471	450
Total traded products						
India	4708	2503	4441	2864	4525	2900
Pak	2558		2965		3004	

Source: Calculated based on UNCOMTRADE

Table 8 lists the common set of traded goods between India and Pakistan, showing relatively higher IIT index scores. Appendix 3 provides the estimated IIT indices for major products for both the partners. The calculated scores suggest the IIT levels are higher in manufactured products than in primary goods, reflecting the greater role of economies of scale in the production of those products. Over 32 percent of total traded products had IIT > 0.50 in case of

²² Refer, for example, Sodersten and Reed (1994)

²³ Before calculating IIT, data coordinates at HS nomenclature H2 were matched for both the countries. The traditional way to measure the degree of intra-industry trade is the Grubel-Lloyd Index (G-L Index), with

following formula: $1 - \frac{|\sum_d x_{isd} - \sum_d m_{ids}|}{\sum_d x_{isd} + \sum_d m_{ids}}$, where s is the country of interest, d is the set of all other

countries in the world, i is the sector of interest, x is the commodity export flow, and m the commodity import flow. In the ratio, the numerator is the absolute value of the difference between total exports and total imports in sector i , the denominator is the sum of the total exports and imports in sector i .

India, which was about 15 percent in case of Pakistan. The IIT index scores also indicate that there is large potential in about 30 products with varying capacity. The range of such potentials varies from textile and clothing, iron and steel, electrical machinery and equipment, mechanical appliances, etc. This indicates that India and Pakistan have the potential to integrate their production structures in many sectors and improve its global competitiveness. The analysis so far indicates that a number of product categories and sectors exhibit an increasing share of IIT having higher economies of scale between India and Pakistan, and these are the sectors where there are the potential for the growth of bilateral trade between the two countries through IIT. This sort of production sharing arrangement may emerge into regional and/or global value chains, if supported by improved logistics and lower NTBs. In order to realize the potential, both the countries have to undertake further trade liberalization, such as reducing tariffs and removing non-tariff barriers, and also take effective action for reducing trade costs by improving trade facilitation both ‘at border’ and ‘behind the border’. It has been argued that by driving down real trade costs and trade and transport logistics barriers, India and Pakistan may realize the potential of higher production-sharing arrangements.²⁴ The World Bank (2010) stated that the drivers of such trade go beyond relative factor endowments to factors such as complementary use of information and communication technologies and natural geographies (clustering, agglomeration, and scale effects).²⁵ Kimura and Kobayashi (2009) argued that according to the fragmentation theory the key to attract fragmented production blocks is to (i) improve locational advantages by, for example, developing special economic zones (SEZs) with at least an improved local-level investment climate and (ii) reduce the cost of service links that connect remotely located production blocks by improving trade and transport facilitation. Therefore, better service links, which refer to improved trade facilitation and connectivity between India and Pakistan, are necessary to facilitate the production networks across the borders. Moreover, unleashing the intraregional trade potential can lead to better allocation of resources between the two countries and also in the region, allow economies of scale, and improve efficiency in production.

4. Pakistan’s MFN to India and Its Impact on Bilateral and Regional Trade

How much would be the bilateral gains from MFN? Do other South Asian countries benefit from India-Pakistan MFN trade? To what extent the MFN trade between India and Pakistan would pull-up the regional trade in South Asia? These are the questions we often face with change in trade environment between India and Pakistan. To answer these questions, we take the help of computable general equilibrium (CGE) modelling. Pakistan’s benefits of trade with India, comparing unit price, are huge. We factor in this benefit quantitatively while modeling the gains from trade.

²⁴Refer to, for example, World Bank (2010), Amjad et al. (2012)

²⁵Manufacturing production sharing (or vertical specialization) is a key characteristic in East Asia’s regional integration and export dynamism. Refer, for example, Ando and Kimura (2009), Kimura and Kobayashi (2009), etc.

Table 9: Unit Price

2 digit HS code	Code Name	No of products at 6 digit HS code level for which 'unit price of import if India becomes the import source' is lower than the 'unit price of import from existing source'	% share of 'possible' import in total import at 2 digit HS code for which 'unit price of import if India becomes the import source' is lower than the 'unit price of import from existing source'	% share of 'possible' import in total import for which 'unit price of import if India becomes the import source' is lower than the 'unit price of import from existing source'
1	Live animals; animal products	3	33.2130	0.0110
2	Meat and edible meat offal	4	1.7019	0.0002
3	Fish and crustaceans, molluscs and other aquatic invertebrates	5	8.0143	0.0005
4	Dairy produce; birds' eggs; natural honey; edible products of animal origin, not elsewhere specified or included	9	17.5244	0.0428
7	Edible vegetables and certain roots and tubers	6	7.0999	0.0959
8	Edible fruit and nuts; peel of citrus fruit or melons	1	0.0002	0.000001
9	Coffee, tea, maté and spices	1	0.0001	0.000001
10	Cereals	4	27.8573	0.0543
11	Products of the milling industry; malt; starches; inulin; wheat gluten	7	83.5677	0.1352
12	Oil seeds and oleaginous fruits; miscellaneous grains, seeds and fruit; industrial or medicinal plants; straw and fodder	4	87.0885	1.4567
13	Lac; gums, resins and other vegetable saps and extracts	2	17.8070	0.0047
15	Animal or vegetable fats and oils and their cleavage products; prepared edible fats; animal or vegetable waxes	14	28.4721	1.4050
17	Sugars and sugar confectionery	6	4.6694	0.1039
18	Cocoa and cocoa preparations	1	41.7007	0.0209
19	Preparations of cereals, flour, starch or milk; pastrycooks' products	3	55.6847	0.1024
20	Preparations of vegetables, fruit, nuts or other parts of plants	6	11.6715	0.0074
21	Miscellaneous edible preparations	5	3.1082	0.0036
22	Beverages, spirits and vinegar	7	11.6154	0.0025
23	Residues and waste from the food industries; prepared animal fodder	7	14.3373	0.0617
24	Tobacco and manufactured tobacco substitutes	6	99.1908	0.0385
25	Salt; sulphur; earths and stone; plastering materials, lime and cement	12	58.5373	0.1372
27	Mineral fuels, mineral oils and products of their distillation; bituminous substances; mineral waxes	16	41.7734	12.6849
28	Inorganic chemicals; organic or inorganic compounds of precious metals, of rare-earth metals, of radioactive elements or of isotopes	31	5.3680	0.0606
29	Organic chemicals	42	17.9378	0.8225
30	Pharmaceutical products	1	0.1769	0.0023

2 digit HS code	Code Name	No of products at 6 digit HS code level for which 'unit price of import if India becomes the import source' is lower than the 'unit price of import from existing source'	% share of 'possible' import in total import at 2 digit HS code for which 'unit price of import if India becomes the import source' is lower than the 'unit price of import from existing source'	% share of 'possible' import in total import for which 'unit price of import if India becomes the import source' is lower than the 'unit price of import from existing source'
31	Fertilisers	5	86.1809	1.4887
32	Tanning or dyeing extracts; tannins and their derivatives; dyes, pigments and other colouring matter; paints and varnishes; putty and other mastics; inks	6	17.5249	0.1475
34	Soap, organic surface-active agents, washing preparations, lubricating preparations, artificialwaxes, prepared waxes, polishing or scouring preparations, candles and similar articles, modelling pastes, "dental waxes" and dental preparations with a basis o	5	6.3058	0.0261
35	Albuminoidal substances; modified starches; glues; enzymes	3	6.5119	0.0061
36	Explosives; pyrotechnic products; matches; pyrophoric alloys; certain combustible preparations	2	4.1041	0.0005
37	Photographic or cinematographic goods	8	45.6573	0.0316
38	Miscellaneous chemical products	13	3.2215	0.0476
39	Plastics and articles thereof	25	10.9331	0.4247
40	Rubber and articles thereof	11	16.5929	0.1825
41	Raw hides and skins(other than furskins) and leather	11	45.0799	0.0936
43	Furskins and artificial fur; manufactures thereof	1	27.9042	0.0015
44	Wood and articles of wood; wood charcoal	11	3.8549	0.0102
46	Manufactures of straw, of esparto or of other plaiting materials; basketware and wickerwork	1	3.6948	0.000034
47	Pulp of wood or of other fibrous cellulosic material; recovered (waste and scrap) of paper or paperboard	7	29.9244	0.0700
48	Paper and paperboard; articles of paper pulp, of paper or of paperboard	20	33.1310	0.3884
49	Printed books, newspapers, pictures and other products of the printing industry; manuscripts, typescripts and plans	4	3.8788	0.0047
51	Wool, fine or coarse animal hair; horsehair yarn and woven fabric	2	5.4159	0.0020
52	Cotton	6	0.0540	0.0012
53	Other vegetable textile fibres; paper yarn and woven fabrics of paper yarn	3	6.4791	0.0129
54	Man-made filaments; strip and the like of man-made textile materials	7	7.7860	0.1070
55	Man-made staple fibres	14	52.1706	0.7020
58	Special woven fabrics; tufted textile fabrics; lace; tapestries; trimmings; embroidery	3	1.6414	0.0017

2 digit HS code	Code Name	No of products at 6 digit HS code level for which 'unit price of import if India becomes the import source' is lower than the 'unit price of import from existing source'	% share of 'possible' import in total import at 2 digit HS code for which 'unit price of import if India becomes the import source' is lower than the 'unit price of import from existing source'	% share of 'possible' import in total import for which 'unit price of import if India becomes the import source' is lower than the 'unit price of import from existing source'
60	Knitted or crocheted fabrics	9	58.1876	0.0353
63	Other made up textile articles; sets; worn clothing and worn textile articles; rags	1	0.0905	0.0004
68	Articles of stone, plaster, cement, asbestos, mica or similar materials	6	5.1436	0.0046
69	Ceramic products	5	44.1050	0.0879
70	Glass and glassware	9	14.1888	0.0263
71	Natural or cultured pearls, precious or semi-precious stones, precious metals, metals clad with precious metal, and articles thereof; imitation jewellery; coin	6	68.5697	0.3340
72	Iron and steel	29	17.1504	0.7745
73	Articles of iron or steel	17	5.1074	0.0578
74	Copper and articles thereof	6	2.2125	0.0081
75	Nickel and articles thereof	3	62.7536	0.0285
76	Aluminum and articles thereof	5	18.0886	0.1038
78	Lead and articles thereof	3	97.7582	0.1415
79	Zinc and articles thereof	3	14.2653	0.0147
81	Other base metals; cermets; articles thereof	5	1.5309	0.0004
84	Nuclear reactors, boilers, machinery and mechanical appliances; parts thereof	33	4.2856	0.3372
85	Electrical machinery and equipment and parts thereof; sound recorders and reproducers, television image and sound recorders and reproducers, and parts and accessories of such articles	13	6.3953	0.4160
86	Railway or tramway locomotives, rolling-stock and parts thereof; railway or tramway track fixtures and fittings and parts thereof; mechanical (including electro-mechanical) traffic signalling equipment of all kinds	1	0.6091	0.0007
87	Vehicles other than railway or tramway rolling-stock, and parts and accessories thereof	14	8.9598	0.3121
88	Aircraft, spacecraft, and parts thereof	3	38.6654	0.1265
90	Optical, photographic, cinematographic, measuring, checking, precision, medical or surgical instruments and apparatus; parts and accessories thereof	8	2.2149	0.0256
93	Arms and ammunition; parts and accessories thereof	1	2.3240	0.0007
94	Furniture; bedding, mattresses, mattress supports, cushions and similar stuffed furnishings; lamps and lighting fittings, not elsewhere specified or included; illuminated signs, illuminated name-	4	21.0204	0.0362

2 digit HS code	Code Name	No of products at 6 digit HS code level for which ‘unit price of import if India becomes the import source’ is lower than the ‘unit price of import from existing source’	% share of ‘possible’ import in total import at 2 digit HS code for which ‘unit price of import if India becomes the import source’ is lower than the ‘unit price of import from existing source’	% share of ‘possible’ import in total import for which ‘unit price of import if India becomes the import source’ is lower than the ‘unit price of import from existing source’
	plates and the like; prefabricated buildings			
95	Toys, games and sports requisites; parts and accessories thereof	3	2.9249	0.0036
96	Miscellaneous manufactured articles	3	23.9438	0.0718

Source: Authors, calculated based on UNCOMTRADE database. The products are classified according to HS classification of 2007.

First, we identify 561 products for Pakistan at the 6-digit HS level from the World Bank’s WITS database, where the unit costs of imports if they are sourced from India would be lower than the unit costs of imports if they are sourced from other countries (Table 9). The percentage differences in these unit import costs are then calculated next. The percentage differences in unit prices for these 561 products at the 6 digit HS code are then aggregated into GTAP sectors matching the concordance and weights for respective products.

Since Pakistan would only enjoy fall in unit import prices for these products if the import source is India, in the GTAP model a scenario (‘MFN’ scenario) is considered, where there would be a fall in import price for Pakistan while importing from India.²⁶ This simulation is done by shocking on the transaction cost of the import from India to Pakistan. In this regard, the “ams” - import-augmenting "technical change" in the Armington nest (which can be used to lower the effective price of imported products) is shocked. In brief, the MFN scenario incorporates the reduction in import prices for Pakistan because of increased potential of sourcing imports from India at cheaper prices. In addition, it is assumed that there would be some ‘peace dividends’ for all the South Asian countries because of this improved trade relation between India and Pakistan. In the GTAP framework, such “peace dividend” is assumed to lower transaction costs in bilateral trade among the South Asian countries by 0.5 percent.

²⁶ A brief description of the GTAP model with country and commodity classifications is presented in Appendix 4.

Table 10: Welfare Effects of MFN
(Equivalent variation in US\$ million at 2007 prices)

Country	Welfare Effects of MFN
Bangladesh	21.08
India	160.71
Nepal	18.01
Pakistan	99.21
Sri Lanka	34.92
Rest of South Asia	15.72
China	-10.52
USA	-18.39
EU 25	-29.55
Rest of the World	-66.71

Source: GTAP simulation

The results of the MFN scenario are presented in Table 10. The simulation indicates that welfare effects of MFN will be positive both for India and Pakistan. The GTAP simulation suggests that there would be some positive welfare effects on other South Asian countries out of the ‘peace dividends’ generating from improved economic cooperation between India and Pakistan. There will however be some negative welfare effects for the countries outside of South Asia, since Pakistan, after giving MFN status to India, would divert the source of some of its imports from other countries to India.

Table 11: Impact of MFN on Pakistan’s Import (% Change in Import from Base)

Sr. No.	Sectors	Import from									
		BDG	IND	NPL	SL	ROSA	China	USA	EU 25	ROW	Total
1	Paddy rice	-	-	-	-	-	-0.47	-	-27.20	0.45	-0.81
2	Wheat	-	-	-	-	-	-	-0.85	18.60	-0.68	-0.45
3	Cereal grains nec	-	6.35	-	-	-	-	-1.32	-2.71	-1.67	-1.12
4	Vegetables, fruit, nuts	-	0.18	-	0.84	1.05	0.14	-0.18	0.47	0.19	0.28
5	Oil seeds	-	450.18	-	-1.70	-4.94	2.70	-	-3.33	-3.12	-0.65
6	Sugar cane, sugar beet	-	-	-	-	-	-	-	-	3.00	8.00
7	Plant-based fibers	1.88	-0.32	-	41.80	0.99	-0.38	-0.08	-0.19	-0.07	0.04
8	Crops nec	2.10	12.55	-2.98	1.70	-0.43	-0.64	-1.88	-0.17	-0.61	0.58
9	Cattle, sheep, Goats, Horses	-	2.80	-	-	-	-	6.10	10.90	-1.43	-0.36
10	Animal products nec	-	27.82	-	47.70	-2.51	-3.77	1.37	-0.56	-1.05	0.54
11	Raw milk	-	2088.90	-	-	-	-	-	-84.40	-77.42	190.83
12	Wool, silk-worm cocoons	-	41.70	-	-	55.90	-49.80	-	-1.10	0.24	0.81
13	Forestry	-1.67	14.08	-	-1.98	-2.24	14.80	-1.55	-2.98	-3.08	0.84
14	Fishing	-	23.85	-	-	-	-2.30	-	13.45	1.45	0.14
15	Coal	-	-	-	-	-	2.90	19.95	28.70	0.32	0.32
16	Oil	-	-	-	-	0.09	-	-	14.23	-0.13	-0.13
17	Gas	-	-	-	-	-	-	-	-	-24.18	-
18	Minerals nec	-	15.87	-	32.30	-29.99	-27.23	27.84	-27.77	-27.76	-

Sr. No.	Sectors	Import from									
		BDG	IND	NPL	SL	ROSA	China	USA	EU 25	ROW	Total
19	Meat: cattle,sheep,goats ,horse	-	347.65	-	-	-	-66.31	65.62	-65.70	-65.44	45.51
20	Meat products nec	-	668.10	-	-	-	12.50	-2.50	0.07	-2.74	1.96
21	Vegetable oils and fats	-	68.62	-	-0.15	-	12.95	-3.20	-3.75	-3.25	1.05
22	Dairy products	-	38.21	-	-	-	-4.17	0.06	-0.41	-0.16	0.91
23	Processed rice	-	11.50	-	-	-	-28.30	-	-	4.40	-3.31
24	Sugar	-	4.23	-	-	-	-	37.90	-2.19	-2.41	2.05
25	Food products nec	-4.74	139.08	-	-4.98	-18.90	-2.40	-2.50	-2.38	-2.49	0.24
26	Beverages and tobacco products	-	26.10	-	-	-	-8.07	-3.83	0.46	0.32	0.23
27	Textiles	1.87	34.01	-	3.56	4.65	-0.48	-0.58	-0.51	-0.46	0.35
28	Wearing apparel	10.57	-9.07	-	15.40	-	0.15	-0.83	-0.22	0.21	0.17
29	Leather products	-	115.55	-	-	-	-5.27	-7.34	-5.23	-5.25	2.46
30	Wood products	-	15.30	-	2.95	3.79	0.32	0.36	0.35	0.34	0.36
31	Paper products, publishing	1.10	77.80	-	10.00	-	-1.22	-1.15	-1.14	-1.16	0.34
32	Petroleum, coal products	-	8.41	-	42.00	6.58	-0.49	-0.39	-0.30	-0.49	0.07
33	Chemical,rubber, plastic prods	5.72	54.82	13.20	-4.26	-14.70	-6.44	-6.44	-6.44	-6.43	0.49
34	Mineral products nec	-	53.42	-	35.70	-	-0.37	-1.87	-0.40	-0.38	0.59
35	Ferrous metals	14.15	45.93	-	-	1.73	-1.35	-1.40	-1.39	-1.37	0.25
36	Metals nec	-	129.97	-	20.75	-4.09	-5.52	-6.06	-5.52	-5.51	-0.22
37	Metal products	28.40	4.19	-	-2.90	10.28	-0.17	0.06	-0.15	-0.14	-0.01
38	Motor vehicles and parts	-	38.50	-	-	8.70	0.18	0.50	0.16	0.19	0.21
39	Transport equipment nec	-	28.26	-	-	-	0.17	0.15	0.15	0.14	0.17
40	Electronic equipment	-	-4.53	-	-	-	0.16	0.10	0.16	0.17	0.16
41	Machinery and equipment nec	4.17	52.86	13.10	-6.52	5.20	-0.11	-0.11	-0.11	-0.11	0.20
42	Manufactures nec	-8.37	10.43	-	-5.35	-	0.20	0.21	0.16	0.17	0.25
43	Electricity	-	-	-	-	-	-	-	-34.20	-	10.40
44	Gas manufacture, distribution	-	-	-	-	-	4.60	-4.83	-2.56	-2.07	0.98
45	Water	-	-	-	-	-	3.60	1.02	2.06	0.66	-0.08
46	Construction	-	2.44	-	-	-44.90	1.45	0.32	0.10	-0.17	-0.05
47	Trade	-	0.30	-	3.00	-12.85	0.56	0.25	0.26	0.30	0.29
48	Transport nec	-	-	-	-	-	-	-	-	-	-
48	Transport nec	12.30	0.09	10.60	11.23	3.87	0.09	0.22	0.20	0.17	0.19
49	Sea transport	16.60	1.27	-	-0.75	-38.10	0.12	-1.03	0.29	0.41	0.37
50	Air transport	-	1.87	-	-	3.00	0.16	0.06	0.04	0.03	0.03
51	Communication	-1.90	-0.37	-	1.20	-11.60	-0.97	0.50	0.25	0.25	0.32
52	Financial	-	1.50	-	-	7.20	2.03	0.31	0.30	0.22	0.30

Sr. No.	Sectors	Import from									
		BDG	IND	NPL	SL	ROSA	China	USA	EU 25	ROW	Total
	services nec										
53	Insurance	-	-2.28	-	23.00	0.70	-1.76	0.43	0.30	0.44	0.38
54	Business services nec	2.96	0.04	21.05	2.72	3.68	0.28	0.23	0.23	0.23	0.22
55	Recreation and other services	-	49.20	39.30	44.70	-11.15	0.39	0.27	0.29	0.28	0.26
56	PubAdmin/Defence/Health/Educat	2.56	0.15	8.42	8.90	10.15	0.17	0.34	0.31	0.34	0.33
57	Dwellings	-	-	-	-	-	-	-	-	-	-
	Total	1.83	32.03	1.63	-1.74	0.59	-1.43	-0.62	-0.90	-1.59	0.28

Notes: ROSA: Rest of South Asia. ROW: Rest of the World

Source: GTAP simulation

Table 11 presents the impact on Pakistan's import due to MFN scenario. The simulations suggest that Pakistan's import from India would rise by 32 percent. Also, there would be some marginal rise in imports from Bangladesh, Nepal and rest of South Asia. However, imports from China, USA, EU25 and rest of the world would decline by some margins.²⁷ This suggests that rise in imports from India would lead to fall in imports from other major sources. Pakistan's total import would however increase by only 0.28 percent. This apparently indicates that mere MFN scenario would not have major impact on Pakistan's total import. A number of sectors in India will benefit in terms of rises in exports to Pakistan due to the MFN status. Such rises in exports from India would happen due to India's unit cost advantage compared to Pakistan's other trading partners. Under this scenario, the change in exports from India to Pakistan would vary from meat (348 percent) to vegetables, fruits and nuts (0.2 percent). Besides, India's exports to Pakistan would rise for chemical, rubber and plastic, food processing, mineral fuels (petroleum, coal products), metals, machinery and equipment, textiles, leather products, dairy products, fishing, etc.

Table 12: Impact on Pakistan's Export (% change in Export from Base)

S. No.	Sectors	Export to									
		BDG	IND	NPL	SL	ROSA	China	USA	EU 25	ROW	Total
1	Paddy rice	-	-	-	39.40	-	-	-0.71	0.02	0.22	-0.16
2	Wheat	3.89	0.32	-	4.59	2.58	-	-	-	0.14	0.55
3	Cereal grains nec	-	-	-	-	-19.40	-	-	-	0.92	-0.32
4	Vegetables, fruit, nuts	-0.92	-0.04	35.30	0.91	1.39	-1.29	-1.47	0.22	0.23	-0.07
5	Oil seeds	33.80	3.20	-	-4.90	9.80	3.79	-	4.94	0.35	0.84
6	Sugar cane, sugar beet	-	-	-	-	-	-	-	-	-	-
7	Plant-based fibers	1.80	11.33	-	-	-	0.72	-	2.33	0.16	0.66
8	Crops nec	4.43	-0.49	13.90	0.59	3.79	-24.00	-0.70	0.11	0.48	-0.11
9	Cattle sheep goats	-	-	-	-	-	-	26.40	3.30	-	-1.15

²⁷ Here, EU25 means 25 member countries of EU.

S. No.	Sectors	Export to									
		BDG	IND	NPL	SL	ROSA	China	USA	EU 25	RO W	Total
	horses									5.33	
10	Animal products nec	11.80	15.20	-	-	0.17	2.95	-5.77	0.15	0.07	-0.04
11	Raw milk	-	-	-	-	-	-16.75	2.85	0.74	0.96	-1.18
12	Wool, silk-worm cocoons	-	2.71	-	-	-	-11.00	-	1.38	8.52	-0.21
13	Forestry	-	-2.67	-	-	2.35	3.13	40.20	0.33	1.55	-0.59
14	Fishing	-	-3.19	-	-	-43.20	-1.36	0.42	11.35	0.00	-0.09
15	Coal	-	-	-	-	-	-	-	-	-	-
16	Oil	-	-	-	-	-	-	-	-	0.60	1.84
17	Gas	-	-	-	-	-	-	-	-	-	-
18	Minerals nec	4.83	0.25	-	-	-4.35	0.66	-0.69	0.94	0.77	0.74
19	Meat: cattle sheep,goats horse	-	-	-	-	-	-	-	-	23.80	3.56
20	Meat products nec	-	-	-	-	-4.00	-	-	-	43.90	1.49
21	Vegetable oils and fats	-	-	-	-	1.23	2.02	10.85	5.90	0.32	1.16
22	Dairy products	-	-	-	-	2.13	-	39.10	2.40	5.94	2.14
23	Processed rice	0.13	-	-	0.72	1.09	5.25	-0.77	0.32	0.29	-0.24
24	Sugar	-	-	-	-	5.27	-47.80	-3.30	0.60	0.07	-0.39
25	Food products nec	0.66	-0.27	-	1.72	0.93	-0.07	-0.17	0.06	0.07	0.28
26	Beverages and tobacco products	-	0.05	-	1.05	0.26	-	1.32	0.11	0.18	-0.04
27	Textiles	2.79	-0.03	49.20	2.13	2.46	-0.02	-0.01	0.01	0.02	0.08
28	Wearing apparel	5.27	-0.63	-	3.03	-12.30	2.39	-0.19	0.20	0.21	-0.20
29	Leather products	2.21	-0.20	-	5.06	2.16	-0.22	-0.52	0.24	0.28	-0.17
30	Wood products	0.90	-	-	-	2.42	0.70	-2.25	0.20	0.18	0.75
31	Paper products, publishing	3.48	0.18	-	-0.10	0.70	-	-1.22	1.45	0.08	0.41
32	Petroleum, coal products	-4.00	0.02	-	49.70	0.73	-12.15	-5.91	1.40	0.03	0.15
33	Chemical,rubber,plastic prods	3.32	0.61	-	2.83	2.67	0.48	0.29	0.54	0.48	0.93
34	Mineral products nec	45.30	-0.27	-	1.78	0.97	21.85	-0.09	0.67	0.06	0.38
35	Ferrous metals	-	-0.01	-	1.99	2.05	0.71	-	0.74	0.49	1.34
36	Metals nec	-	6.34	-	8.39	14.80	6.57	2.68	5.98	6.57	6.56
37	Metal products	7.41	12.90	-	2.10	5.53	0.81	2.77	2.63	2.70	3.23
38	Motor vehicles and parts	0.04	6.45	-	-2.12	3.50	-	0.02	0.84	0.03	0.44
39	Transport equipment nec	5.59	-	-	47.30	13.30	-32.00	-2.83	0.00	0.04	0.65
40	Electronic equipment	13.15	-	-	-6.70	11.00	-	0.99	0.23	0.04	0.16
41	Machinery and	3.10	-0.93	11.15	3.68	3.10	0.74	-0.22	-	-	0.12

S. No.	Sectors	Export to									
		BDG	IND	NPL	SL	ROSA	China	USA	EU 25	ROW	Total
	equipment nec								0.15	0.12	
42	Manufactures nec	8.37	7.87	-	-5.00	2.44	-2.16	-0.09	0.08	0.09	-0.02
43	Electricity	-	-	-	-	-	-	-	-	-	-
44	Gas manufacture, distribution	-	-	-	-	-	-	-	11.70	25.50	-13.60
45	Water	-	-	-	-	-	-	-	24.80	23.35	10.17
46	Construction	-	-2.97	-	-	-43.10	0.96	0.86	0.53	0.37	0.38
47	Trade	-	-5.64	-	-	-17.20	0.06	-1.18	0.56	0.43	-0.33
48	Transport nec	41.40	-2.26	45.70	21.00	-1.77	0.58	-0.07	0.01	0.04	-0.09
49	Sea transport	-	0.94	-	15.13	-46.50	0.95	3.47	0.39	0.33	-0.31
50	Air transport	1.79	0.59	-0.04	-	-3.93	0.31	0.26	0.26	0.26	0.26
51	Communication	-	0.26	-	15.00	-	-0.69	-0.58	0.45	0.41	-0.38
52	Financial services nec	-	-1.73	-	-	0.90	-1.33	-0.70	0.56	0.18	-0.42
53	Insurance	-	-4.76	-	-	-43.30	0.89	-0.29	0.41	0.45	-0.48
54	Business services nec	25.30	-0.06	40.70	7.25	0.40	-0.39	-0.26	0.26	0.26	-0.28
55	Recreation and other services	-	2.55	-	-	-25.70	-3.41	-0.06	0.12	0.04	-0.11
56	PubAdmin/Defence/Health/Educat	1.24	-0.73	3.20	3.50	-5.20	-0.62	-0.34	0.36	0.35	-0.34
57	Dwellings	-	-	-	-	-	-	-	-	-	-
	Total	2.73	0.40	2.62	2.14	1.50	0.67	-0.09	0.06	0.15	0.17

Notes: ROSA: Rest of South Asia. ROW: Rest of the World

Source: GTAP simulation

The impact of the MFN scenario on Pakistan's total exports would also be minimal (Table 12). Pakistan's total exports may rise by only 0.17 percent and the exports to India in particular may rise by 0.4 percent. MFN status to India would thus have negligible impact on Pakistan's sectoral exports to India. There would however be some rise in the exports of plant based fibers, animal products and metals from Pakistan to India. Pakistan would experience some rise in exports to Bangladesh, Nepal, Sri Lanka, Rest of South Asia and China. At the same time, Pakistan would experience some marginal fall in exports to its major export destinations such as USA and EU25. This suggests that the MFN scenario would lead Pakistan to reorient some of its exports to the South Asian region.

Table 13: Impact on India's Import (% Change in Import from Base)

	Sectors	Import from									
		BDG	NPL	PAK	SL	ROSA	China	USA	EU 25	RO W	Total
1	Paddy rice	-	-	-	-	-	-	16.43	-	-3.88	-1.01
2	Wheat	-	-	-0.09	-	-	-	-	-0.04	0.27	0.26
3	Cereal grains nec	-	6.00	-	-	-	-	5.35	24.40	0.23	0.92
4	Vegetables, fruit, nuts	0.77	-0.44	-0.18	2.99	0.85	0.24	0.16	0.12	0.17	0.19
5	Oil seeds	-	5.40	21.75	-	-	-	15.30	38.10	0.49	0.42
6	Sugar cane, sugar beet	-	-	-	-	-	-	-	-	8.52	9.62
7	Plant-based fibers	1.78	-	-5.20	19.90	-	2.07	-0.14	-0.48	-0.16	0.24
8	Crops nec	49.60	0.96	-0.86	2.60	3.13	-0.10	0.50	0.29	0.20	0.52
9	Cattle,sheep,goats,horses	-	-	-	-	-	-	20.00	1.71	1.43	1.43
10	Animal products nec	0.72	5.14	24.15	34.70	-	0.76	0.16	0.07	0.18	0.16
11	Raw milk	-	-	-	-	-10.70	-	6.40	0.70	-1.33	2.62
12	Wool, silk-worm cocoons	-	-	-3.16	-	-	-0.21	0.26	0.60	0.47	0.46
13	Forestry	39.40	0.16	3.49	0.73	1.07	3.32	0.93	0.16	0.13	0.15
14	Fishing	0.33	-	4.42	6.61	-	-1.68	10.37	-1.27	0.03	0.24
15	Coal	-	-	-	-	13.50	0.19	0.06	4.60	0.07	0.07
16	Oil	-	-	-	-	4.48	-1.33	39.30	0.20	0.08	0.08
17	Gas	-	-	-	-	-	-	-	-	0.23	0.23
18	Minerals nec	-0.26	0.31	0.08	-0.32	0.16	-0.01	-0.02	0.00	0.00	0.00
19	Meat: cattle,sheep,goats,horse	-	-	-	-	-	1.33	0.30	-1.14	-0.09	0.20
20	Meat products nec	-	-	-	2.38	-	-8.40	-0.44	1.39	0.20	0.35
21	Vegetable oils and fats	2.89	2.42	-	2.10	2.53	0.67	-0.16	-0.06	0.16	0.30
22	Dairy products	-	1.00	-	-	0.96	-1.11	0.37	0.17	-0.04	0.20
23	Processed rice	-	-	-	-	-	-	38.80	16.70	-0.37	-0.72
24	Sugar	4.30	9.46	-	-	-	-	1.57	-0.08	0.09	0.20
25	Food products nec	1.57	1.09	0.48	1.51	0.80	0.13	0.10	0.06	0.09	0.20
26	Beverages and tobacco products	0.32	0.48	2.06	21.10	0.15	1.18	0.28	0.04	0.05	0.11
27	Textiles	3.26	2.51	-0.01	2.53	2.83	0.07	0.09	0.07	0.07	0.23
28	Wearing apparel	4.06	1.40	-3.50	1.10	-40.10	0.03	0.22	0.11	0.15	0.26
29	Leather products	2.99	1.30	0.12	4.33	-40.20	0.14	0.05	0.15	0.13	0.17

		Import from									
	Sectors	BDG	NPL	PAK	SL	ROSA	China	USA	EU 25	RO W	Total
9											
30	Wood products	5.81	2.27	-	2.66	2.31	0.12	0.14	0.11	0.15	0.25
31	Paper products, publishing	6.37	2.46	-1.85	2.47	-44.40	0.13	0.13	0.14	0.13	0.15
32	Petroleum, coal products	-	-	-0.02	-0.65	1.77	0.07	0.08	0.08	0.07	0.07
33	Chemical, rubber, plastic prods	2.96	4.18	0.55	2.66	3.69	0.18	0.17	0.17	0.18	0.21
34	Mineral products nec	2.67	0.98	0.17	1.64	17.10	0.12	0.10	0.11	0.12	0.17
35	Ferrous metals	2.37	2.49	1.37	4.08	3.04	0.07	0.06	0.06	0.07	0.11
36	Metals nec	3.62	0.57	6.23	4.37	2.28	0.00	-0.01	0.00	0.01	0.03
37	Metal products	2.05	0.95	-6.65	4.74	-11.00	0.15	0.14	0.14	0.15	0.15
38	Motor vehicles and parts	-	-	10.65	1.70	-12.85	0.15	0.12	0.12	0.13	0.13
39	Transport equipment nec	6.37	6.47	49.40	4.45	-	0.07	0.07	0.07	0.08	0.08
40	Electronic equipment	4.33	-	-	-6.60	-	0.08	0.07	0.08	0.08	0.08
41	Machinery and equipment nec	3.67	4.31	0.10	3.65	-7.80	0.12	0.12	0.12	0.12	0.13
42	Manufactures nec	2.46	-2.47	0.10	2.45	2.11	0.12	0.11	0.11	0.11	0.12
43	Electricity	-	1.32	-	-	1.71	0.57	-0.26	-0.22	-0.23	0.36
44	Gas manufacture, distribution	-	-	-	-	-	2.07	0.29	-0.08	0.21	0.14
45	Water	-	-	-	-	-	-2.25	0.15	0.70	0.22	0.27
46	Construction	12.60	14.13	-2.97	8.27	-7.04	0.02	0.10	0.09	0.09	0.10
47	Trade	-7.70	15.87	-5.64	-1.32	3.75	0.14	0.13	0.13	0.13	0.13
48	Transport nec	0.97	-5.44	-2.26	2.79	0.14	0.08	0.10	0.10	0.10	0.11
49	Sea transport	3.78	-	0.94	1.30	7.74	1.09	0.02	0.06	0.06	0.07
50	Air transport	20.20	-8.80	0.59	-9.30	3.16	0.07	0.05	0.06	0.06	0.06
51	Communication	3.82	3.13	0.26	7.16	7.13	0.03	0.06	0.09	0.08	0.10
52	Financial services nec	15.67	3.87	-1.73	-1.00	0.28	0.89	0.12	0.12	0.12	0.12
53	Insurance	10.40	-4.40	-4.76	1.03	0.04	0.09	0.09	0.10	0.11	0.11
54	Business services nec	1.48	0.44	-0.06	0.83	0.94	0.04	0.03	0.03	0.04	0.03
55	Recreation and other services	42.60	-2.73	2.55	2.70	0.82	-0.10	0.09	0.09	0.09	0.10
56	PubAdmin/Defence/Health/Educat	0.92	9.90	-0.73	-8.07	1.71	0.37	0.03	0.02	0.03	0.03
5	Dwellings	-	-	-	-	-	-	-	-	-	-

		Import from									
	Sectors	BDG	NPL	PAK	SL	ROSA	China	USA	EU 25	ROW	Total
7											
	Total	2.61	2.39	0.40	2.51	2.01	0.11	0.09	0.08	0.08	0.10

Notes: ROSA: Rest of South Asia. ROW: Rest of the World

Source: GTAP simulation

Table 14: Impact on India's Export (% Change in Export from Base)

		Export to									
	Sectors	BDG	NPL	PAK	SL	ROSA	China	USA	EU 25	ROW	Total
1	Paddy rice	4.83	2.17	-	-7.50	-	-40.30	-0.55	-0.42	-0.73	-0.39
2	Wheat	-	42.50	-	10.30	3.35	-	-5.80	7.70	2.38	5.87
3	Cereal grains nec	-0.11	1.16	5.77	0.07	-	-0.02	-0.76	0.11	-0.16	-0.06
4	Vegetables, fruit, nuts	0.89	1.62	0.12	1.09	1.98	-0.17	-0.24	-0.21	-0.19	-0.02
5	Oil seeds	-	1.79	466.64	5.13	-22.30	-0.41	-0.45	-0.50	-0.50	1.28
6	Sugar cane, sugar beet	-	1.47	-	-	-	-	9.26	2.14	-4.84	-1.24
7	Plant-based fibers	1.69	1.19	-0.32	37.60	-	-0.17	-1.37	-0.28	-0.22	-0.15
8	Crops nec	1.31	2.47	12.49	1.86	3.57	0.03	-0.45	-0.45	-0.43	-0.01
9	Cattle,sheep,goats,horses	-	1.06	43.65	-	-37.10	-	6.10	-6.05	-0.53	0.66
10	Animal products nec	7.04	10.50	25.50	22.20	0.85	-1.40	-0.35	-0.08	-0.07	0.26
11	Raw milk	-	-	2088.90	-	-	3.12	-0.58	-0.43	-0.52	2.19
12	Wool, silk-worm cocoons	-	-	41.70	-	-	-1.12	-0.18	-0.51	-0.66	-0.74
13	Forestry	3.53	8.28	15.22	1.85	8.53	-1.60	-0.22	-0.19	-0.22	0.52
14	Fishing	-2.40	10.58	15.65	4.64	2.43	1.87	-0.11	-0.06	-0.13	-0.15
15	Coal	-0.40	0.36	-	-	-1.23	-	-8.95	-8.16	-1.87	0.07
16	Oil	-	-	-	-4.70	-8.50	-	-	-	-	2.52
17	Gas	-	-	-	-	-	-	-	-	-	-
18	Minerals nec	0.30	0.36	15.91	-0.27	-0.34	-0.03	0.00	-0.03	-0.04	0.05
19	Meat: cattle,sheep,goats,horse	-	-4.45	347.10	-	1.10	-	-1.97	-3.62	-0.39	6.59
20	Meat products nec	28.10	-5.20	642.80	8.30	3.83	-	14.53	-0.93	-0.52	2.77
21	Vegetable oils and fats	2.19	1.86	68.76	2.21	-3.00	-0.47	-0.57	-0.49	-0.46	2.73
22	Dairy products	2.67	2.54	36.03	3.83	1.41	-0.34	-0.35	-0.40	-0.37	0.31
23	Processed rice	0.74	1.58	11.50	1.04	0.75	5.93	-0.25	-0.13	-0.18	0.01
24	Sugar	1.30	0.78	4.26	0.26	0.02	-0.33	-0.65	-0.23	-0.28	0.28
25	Food products nec	1.17	1.26	143.19	1.03	0.42	-0.17	-0.19	-0.19	-0.19	-0.01
26	Beverages and tobacco products	12.07	1.22	23.40	1.54	0.60	-0.53	-0.21	-0.12	-0.08	0.03
27	Textiles	2.49	2.01	34.00	1.80	2.04	-0.31	-0.30	-0.30	-0.30	-0.10
28	Wearing apparel	3.09	4.20	11.23	2.64	2.83	-0.62	-0.30	-0.30	-0.31	-0.29

		Export to									
	Sectors	BDG	NPL	PAK	SL	ROSA	China	USA	EU 25	RO WA	Total
29	Leather products	3.25	2.62	115.0 4	0.79	6.40	-0.43	-0.40	-0.40	-0.42	-0.12
30	Wood products	4.17	1.75	0.10	2.28	2.75	0.31	-0.27	-0.30	-0.28	-0.23
31	Paper products, publishing	2.30	1.86	77.13	1.85	1.68	-0.26	-0.23	-0.25	-0.24	1.14
32	Petroleum, coal products	1.42	-0.19	8.40	0.18	0.31	-0.12	-0.03	-0.03	-0.03	0.10
33	Chemical,rubber,plastic prods	2.29	1.61	54.83	2.11	1.96	-0.21	-0.21	-0.21	-0.21	1.49
34	Mineral products nec	1.71	0.44	53.02	2.06	0.29	-0.31	-0.20	-0.21	-0.20	-0.04
35	Ferrous metals	1.82	1.16	46.11	1.12	1.53	-0.22	-0.21	-0.21	-0.21	0.12
36	Metals nec	3.19	3.91	129.1 8	2.21	5.19	-0.32	-0.29	-0.32	-0.31	0.05
37	Metal products	2.64	1.73	4.30	2.76	2.74	-0.33	-0.27	-0.27	-0.27	-0.20
38	Motor vehicles and parts	1.46	0.94	33.88	1.46	1.94	-0.28	-0.21	-0.22	-0.22	-0.08
39	Transport equipment nec	3.31	0.95	25.92	1.55	0.11	4.03	-0.40	-0.37	-0.34	-0.03
40	Electronic equipment	3.30	2.92	-6.93	3.78	3.13	-0.30	-0.30	-0.32	-0.31	-0.22
41	Machinery and equipment nec	3.09	1.97	52.76	3.10	2.81	-0.30	-0.30	-0.30	-0.30	-0.06
42	Manufactures nec	3.08	2.27	8.64	2.71	1.57	-0.31	-0.31	-0.32	-0.30	-0.30
43	Electricity	-	-6.25	-	-	5.29	-4.98	-0.95	0.15	-0.37	-0.07
44	Gas manufacture, distribution	-	-	-	-	-	-	25.00	-7.92	10.93	4.28
45	Water	-	-	-	-	-	-18.90	-0.88	-1.14	-1.18	-1.04
46	Construction	-	-	2.44	-9.60	5.38	-0.39	-0.38	-0.12	-0.16	-0.16
47	Trade	-1.80	9.97	0.30	11.34	2.05	-0.18	-0.18	-0.19	-0.19	-0.19
48	Transport nec	-1.19	1.63	0.09	1.88	2.77	-0.18	-0.14	-0.14	-0.14	-0.14
49	Sea transport	-3.50	-2.32	1.27	-0.09	3.66	-0.24	-0.10	-0.14	-0.14	-0.13
50	Air transport	3.85	-4.60	1.87	20.05	-2.45	0.33	-0.14	-0.15	-0.15	-0.15
51	Communication	5.27	15.40	-0.37	0.42	-0.08	-0.08	-0.17	-0.18	-0.17	-0.17
52	Financial services nec	-5.24	37.30	1.50	16.70	4.32	-0.22	-0.18	-0.18	-0.18	-0.18
53	Insurance	1.56	-4.05	-2.28	2.99	-0.60	-0.16	-0.17	-0.18	-0.18	-0.18
54	Business services nec	0.71	0.12	0.04	1.31	0.70	-0.16	-0.15	-0.16	-0.16	-0.16
55	Recreation and other services	-	-	49.20	-	-21.35	-0.99	-0.27	-0.16	-0.15	-0.17
56	PubAdmin/Defence /Health/Educat	3.69	-6.33	0.15	-4.46	0.41	-0.33	-0.17	-0.19	-0.18	-0.17
57	Dwellings	-	-	-	-	-	-	-	-	-	-
	Total	1.77	0.93	32.18	0.96	1.74	-0.13	-0.22	-0.21	-0.21	0.12

Notes: ROSA: Rest of South Asia. ROW: Rest of the World

Source: GTAP simulation

The impact of the MFN scenario on India's imports and exports are reported in Table 13 and Table 14 respectively. India's total import would rise by only 0.1 percent, and its import from Pakistan would rise by only 0.4 percent. Other South Asian countries would experience some rises in exports to India due to the "peace dividend" of the MFN scenario assumed in the GTAP model simulation. This suggests that the mere MFN scenario would not have much

impact on India's imports. Also, India's total exports would rise by only 0.12 percent with a large rise in exports to Pakistan by 32 percent. In a static sense, India would experience some small reductions in its exports to China, USA and EU25.

The aforementioned analysis points to the possibility that though the MFN scenario would generate some welfare and export gains for both India and Pakistan, but such gains are appeared to be small. This suggests that mere MFN would not be enough, and to reap larger benefits extended economic cooperation between India and Pakistan might be needed. In order to explore such possibilities this study also undertakes several other scenarios in the GTAP framework. These scenarios include a bilateral FTA between India and Pakistan, a bilateral FTA plus increased bilateral trade facilitation, a SAFTA scenario (where all South Asian countries reduce their bilateral tariffs on goods trade to zero) and a SAFTA scenario plus regional trade facilitation scenario. It should however be mentioned that all these scenarios incorporate MFN scenario. The reason of incorporating MFN scenario is to highlight that full and effective implementation of any bilateral FTA between India and Pakistan or SAFTA would require Pakistan granting MFN status to India,

Table 15: Comparison of Welfare Effects

(Equivalent variation in US\$ million at 2007 prices)

Country	MFN	MFN plus IND-PAK FTA	MFN plus IND-PAK FTA with bilateral trade facilitation	MFN plus SAFTA	MFN plus SAFTA with regional trade facilitation
Bangladesh	21.08	-2.58	-14.59	-111.77	1479.56
India	160.71	376.43	2288.46	1810.73	5452.03
Nepal	18.01	-0.65	-6.85	485.03	1654.21
Pakistan	99.21	443.96	1964.11	1121.67	2618.38
Sri Lanka	34.92	-4.28	-15.56	71.88	2173.12
Rest of South Asia	15.72	-20.27	-41.22	298.21	1265.02
China	-10.52	-4.81	-128.04	-216.19	-760.12
USA	-18.39	-62.13	-223.79	-270.47	-985.54
EU 25	-29.55	-38.32	-262.74	-348.32	-1394.91
Rest of the World	-66.71	-185.81	-861.13	-681.72	-3020.78

Source: GTAP simulation

Table 15 presents the welfare effects of different scenarios. Under a bilateral FTA scenario, both India and Pakistan gain and the gain of Pakistan would be larger than that of India. Other countries would however experience some welfare losses due to exclusion in the FTA. The gains from the bilateral FTA would be much larger for both countries when it would be associated with enhanced bilateral trade facilitation.²⁸ Under this scenario, however, the size of the welfare gain for India would be larger than that for Pakistan. It should be mentioned here that a deeper bilateral economic cooperation between India and Pakistan may give rise to some concerns about the prospect of deepening economic cooperation among countries of South Asia. Therefore, an effective implementation of the SAFTA would be more desirable for the South Asian countries. A scenario of SAFTA is thus also run and the simulation

²⁸ Under the bilateral trade facilitation scenario, the transaction costs in the bilateral trade between India and Pakistan are reduced by 25 percent. In this regard, the "ams" - import-augmenting "technical change" in the Armington nest in the GTAP model (which can be used to lower the effective price of imported products) is shocked.

results suggest larger welfare gains for both India and Pakistan. In terms of gains in both allocative efficiency and terms of trade, a full SAFTA would generate much larger welfare gains for India and Pakistan than those under a mere bilateral FTA between these two countries. There would be welfare loss for Bangladesh due to the possibility of a larger trade diversion effect than the trade creation effect.²⁹ However, when the SAFTA scenario is run considering a regional trade facilitation scenario, welfare gains for all South Asian countries would increase dramatically, and Bangladesh's welfare loss would be more than compensated resulting in large welfare gain.³⁰ Under this scenario, the welfare gains of India and Pakistan would be much higher than those under any other scenarios.

Table 16: Impacts on Pakistan's Imports under Different Scenarios
(% change in import from base)

S. No.	Sectors	MFN	MFN + IND-PAK FTA	MFN + IND- PAK FTA with bilateral TF	MFN + SAFTA	MFN + SAFTA with regional TF
1	Paddy rice	-0.81	5.30	11.77	7.69	18.74
2	Wheat	-0.45	42.54	75.88	45.56	91.46
3	Cereal grains nec	-1.12	1.82	1.66	2.81	6.75
4	Vegetables, fruit, nuts	0.28	8.68	21.06	12.45	30.17
5	Oil seeds	-0.65	-1.48	-5.75	-0.67	-2.95
6	Sugar cane, sugar beet	8	14.10	20.90	0.00	17.61
7	Plant-based fibers	0.04	3.81	13.45	5.80	18.12
8	Crops nec	0.58	15.24	39.42	18.34	51.60
9	Cattle,sheep,goats,horses	-0.36	7.75	18.47	9.52	25.21
10	Animal products nec	0.54	6.18	12.97	7.42	17.35
11	Raw milk	190.8 3	61.65	195.94	62.50	125.52
12	Wool, silk-worm cocoons	0.81	18.58	47.61	23.08	75.00
13	Forestry	0.84	21.16	44.12	34.07	61.94
14	Fishing	0.14	2.72	7.81	5.88	12.39
15	Coal	0.32	0.51	2.60	1.23	5.25
16	Oil	-0.13	-0.25	-1.48	-0.03	-0.42
17	Gas	-21.6	-23.33	-71.43	-25.00	-56.38
18	Minerals nec	- 10.23	-3.15	-3.45	-2.94	2.37
19	Meat: cattle,sheep,goats,horse	45.51	29.75	85.92	31.85	69.89
20	Meat products nec	1.96	9.37	35.96	12.43	47.78
21	Vegetable oils and fats	1.05	7.40	21.57	8.80	25.84
22	Dairy products	0.91	14.52	52.50	17.35	64.89
23	Processed rice	-3.31	-0.15	9.79	0.00	22.42
24	Sugar	2.05	27.39	85.69	29.42	94.20
25	Food products nec	0.24	10.60	19.01	11.75	23.38
26	Beverages and tobacco products	0.23	1.82	5.50	2.99	9.08
27	Textiles	0.35	2.93	13.11	5.04	20.40

²⁹ Refer to Raihan (2012).

³⁰ Under the regional trade facilitation scenario, the transaction costs in the regional trade among the South Asian countries are reduced by 25 percent. In this regard, the "ams" - import-augmenting "technical change" in the Armington nest in the GTAP model (which can be used to lower the effective price of imported products) is shocked.

S. No.	Sectors	MFN	MFN + IND-PAK FTA	MFN + IND- PAK FTA with bilateral TF	MFN + SAFT A	MFN + SAFTA with regional TF
28	Wearing apparel	0.17	1.97	5.81	3.82	13.78
29	Leather products	2.46	22.33	73.75	24.34	80.59
30	Wood products	0.36	1.68	7.60	3.90	17.72
31	Paper products, publishing	0.34	0.99	4.61	1.98	7.94
32	Petroleum, coal products	0.07	2.20	4.86	2.44	5.88
33	Chemical,rubber,plastic prods	0.49	3.42	9.88	4.26	12.61
34	Mineral products nec	0.59	4.48	17.40	6.46	25.46
35	Ferrous metals	0.25	0.92	3.82	1.91	7.25
36	Metals nec	-0.22	1.99	13.81	2.68	16.19
37	Metal products	-0.01	1.69	4.43	2.11	5.87
38	Motor vehicles and parts	0.21	0.91	3.68	1.64	6.27
39	Transport equipment nec	0.17	0.67	2.84	1.31	5.00
40	Electronic equipment	0.16	2.01	7.42	3.78	14.25
41	Machinery and equipment nec	0.2	0.50	2.12	0.81	3.23
42	Manufactures nec	0.25	3.61	13.74	5.54	21.44
43	Electricity	10.4	12.30	16.50	0.00	11.42
44	Gas manufacture, distribution	0.98	3.83	9.26	6.67	16.78
45	Water	-0.08	-0.66	4.69	1.59	11.80
46	Construction	-0.05	1.43	5.91	2.63	10.90
47	Trade	0.29	1.95	7.45	3.47	13.23
48	Transport nec	0.19	1.21	4.81	2.21	8.76
49	Sea transport	0.37	1.90	6.93	3.09	11.70
50	Air transport	0.03	1.20	4.21	2.15	8.00
51	Communication	0.32	1.54	6.41	2.66	10.81
52	Financial services nec	0.3	1.20	5.53	2.31	9.73
53	Insurance	0.38	2.04	8.03	3.48	13.63
54	Business services nec	0.22	1.11	4.49	1.93	7.59
55	Recreation and other services	0.26	1.93	6.94	3.31	12.44
56	PubAdmin/Defence/Health /Educat	0.33	2.57	8.32	4.04	14.33
57	Dwellings	-	-	-	-	-
	Total	0.28	2.40	7.35	3.29	10.50

Note: TF stands for trade facilitation

Source: GTAP simulation

Table 17: Impacts on Pakistan's Exports under Different Scenarios
(% change in export from base)

S. No.	Sectors	MFN	MFN + IND- PAK FTA	MFN + IND-PAK FTA with bilateral TF	MFN + SAFT A	MFN + SAFTA with regional TF
1	Paddy rice	-0.16	-18.50	-31.02	-21.11	-38.56
2	Wheat	0.55	947.30	1547.24	938.31	1542.90
3	Cereal grains nec	-0.32	-4.65	-7.65	0.00	8.09
4	Vegetables, fruit, nuts	-0.07	21.25	46.68	43.34	81.64

S. No.	Sectors	MF N	MFN + IND-PAK FTA	MFN + IND-PAK FTA with bilateral TF	MFN + SAFTA A	MFN + SAFTA with regional TF
5	Oil seeds	0.84	-4.48	-4.36	-3.88	3.27
6	Sugar cane, sugar beet	-	-	-	-	-32.35
7	Plant-based fibers	0.66	-7.25	-7.89	-9.17	20.19
8	Crops nec	-0.11	4.56	43.93	-0.92	35.37
9	Cattle,sheep,goats,horses	-1.15	-11.40	-19.84	-14.29	-21.03
10	Animal products nec	-0.04	-6.09	-10.88	-6.51	-12.44
11	Raw milk	-1.18	-23.63	-38.79	-25.93	-45.90
12	Wool, silk-worm cocoons	-0.21	116.50	1464.14	105.26	1223.87
13	Forestry	-0.59	28.31	81.75	31.48	96.17
14	Fishing	-0.09	0.92	-0.36	0.00	-3.97
15	Coal	-	-	-	-	125.00
16	Oil	1.84	1.42	2.34	0.00	-3.12
17	Gas	-	-	-	-	983.33
18	Minerals nec	0.74	0.86	0.97	0.85	-0.02
19	Meat: cattle,sheep,goats,horse	3.67	-5.64	-13.73	-9.52	-26.82
20	Meat products nec	-0.09	-10.71	-26.58	-11.11	5.79
21	Vegetable oils and fats	1.16	-4.24	-7.91	15.50	56.01
22	Dairy products	2.14	-6.18	-15.33	54.05	248.36
23	Processed rice	-0.24	-5.87	-12.81	-6.23	-13.48
24	Sugar	-0.39	-6.25	-14.13	-8.22	-21.05
25	Food products nec	0.28	-17.45	-26.63	-13.86	-8.27
26	Beverages and tobacco products	-0.04	1.20	-0.24	13.55	17.99
27	Textiles	0.08	-3.57	-1.20	-1.90	2.54
28	Wearing apparel	-0.2	-4.50	-9.96	-7.48	-19.25
29	Leather products	-0.17	-9.35	-4.55	-12.59	-12.59
30	Wood products	0.75	-2.47	-9.51	13.45	80.93
31	Paper products, publishing	0.41	3.32	19.87	13.08	65.40
32	Petroleum, coal products	0.15	7.74	25.52	10.50	36.63
33	Chemical,rubber,plastic prods	0.93	2.24	17.88	6.28	39.85
34	Mineral products nec	0.38	1.83	9.94	7.34	33.62
35	Ferrous metals	1.34	6.71	26.75	27.63	147.10
36	Metals nec	6.56	10.47	67.31	6.88	44.32
37	Metal products	3.23	-2.50	-9.40	0.07	22.42
38	Motor vehicles and parts	0.44	-0.25	0.83	4.55	20.33
39	Transport equipment nec	0.65	-1.87	-3.65	16.91	52.40
40	Electronic equipment	0.16	-4.76	-14.13	-5.69	-9.11
41	Machinery and equipment nec	0.12	-0.73	7.04	-0.78	15.99
42	Manufactures nec	-0.02	-4.13	-11.02	-5.16	-15.83
43	Electricity	-	-	-	-	-7.32
44	Gas manufacture, distribution	-13.6	-17.75	-26.40	0.00	-25.37
45	Water	10.17	6.70	-1.33	0.00	-19.47
46	Construction	0.38	-1.79	-5.03	-3.43	-10.63
47	Trade	-0.33	-3.32	-9.24	-5.25	-15.61
48	Transport nec	-0.09	-1.10	-2.78	-2.30	-6.78
49	Sea transport	-0.31	-2.41	-5.89	-4.22	-11.71
50	Air transport	0.26	-1.35	-3.06	-2.76	-8.05
51	Communication	-0.38	-2.60	-8.26	-4.52	-14.48
52	Financial services nec	-0.42	-2.61	-7.11	-4.43	-12.92
53	Insurance	-0.48	-2.64	-8.11	-4.68	-14.30
54	Business services nec	-0.28	-2.37	-6.23	-4.19	-12.36
55	Recreation and other services	-0.11	-2.01	-6.30	-3.65	-11.77

S. No.	Sectors	MFN	MFN + IND-PAK FTA	MFN + IND-PAK FTA with bilateral TF	MFN + SAFTA	MFN + SAFTA with regional TF
56	PubAdmin/Defence/Health/Education	-0.34	-2.82	-8.47	-4.63	-14.40
57	Dwellings	-	-	-	-	-
	Total	0.17	3.51	8.94	4.21	11.33

Note: TF stands for trade facilitation

Source: GTAP simulation

The impacts on Pakistan's imports and exports are presented in Tables 16 and 17, respectively. The scenarios with enhanced trade facilitation would result in much larger rise in Pakistan's overall imports and exports. Under the bilateral FTA scenario with trade facilitation, Pakistan's total imports would rise by 7.35 percent which would be 4.95 percentage points higher than that under the bilateral FTA scenario. Similarly, the rise in total exports would be 5.4 percentage points higher under the former scenario than under the later scenario. Similar observations can also be made for the SAFTA scenarios. The rises in imports and exports would be the highest under the scenario of SAFTA with enhanced regional trade facilitation. It should also be mentioned that mere MFN scenario would result in least rises in imports and exports for Pakistan. Though magnitudes are lower, similar results are observed as far as the impacts of different scenarios on India's imports and exports are concerned (Tables 18 and 19).

Table 18: Impacts on India's Imports under Different Scenarios
(% change in import from base)

S. No.	Sectors	MFN	MFN + IND-PAK FTA	MFN + IND-PAK FTA with bilateral TF	MFN + SAFTA	MFN + SAFTA with regional TF
1	Paddy rice	-1.01	-1.80	-0.88	0.00	4.97
2	Wheat	0.26	192.75	330.61	191.22	325.11
3	Cereal grains nec	0.92	0.65	1.19	0.00	1.83
4	Vegetables, fruit, nuts	0.19	1.40	3.57	3.18	7.96
5	Oil seeds	0.42	0.72	3.93	1.33	6.81
6	Sugar cane, sugar beet	9.62	9.06	10.54	20.00	6.18
7	Plant-based fibers	0.24	0.06	1.62	6.16	26.83
8	Crops nec	0.52	1.63	8.12	38.89	55.17
9	Cattle,sheep,goats,horses	1.43	0.44	2.23	0.00	3.79
10	Animal products nec	0.16	-0.11	0.48	0.51	2.67
11	Raw milk	2.62	1.28	4.43	0.00	7.94
12	Wool, silk-worm cocoons	0.46	-0.01	7.89	1.54	15.32
13	Forestry	0.15	0.33	1.28	1.95	5.03
14	Fishing	0.24	1.48	2.71	2.01	7.31
15	Coal	0.07	-0.54	-0.79	-0.20	0.36
16	Oil	0.08	0.22	0.76	0.70	1.70
17	Gas	0.23	0.10	0.86	0.26	1.38
18	Minerals nec	0	0.03	0.05	0.05	0.10
19	Meat: cattle,sheep,goats,horse	0.2	0.57	3.58	1.11	6.86
20	Meat products nec	0.35	-0.72	0.75	0.00	10.77

S. No.	Sectors	MFN	MFN + IND-PAK FTA	MFN + IND-PAK FTA with bilateral TF	MFN + SAFTA	MFN + SAFTA with regional TF
21	Vegetable oils and fats	0.3	0.04	1.14	5.91	16.42
22	Dairy products	0.2	-0.19	0.92	9.73	10.65
23	Processed rice	-0.72	-1.03	-0.28	0.00	4.24
24	Sugar	0.2	-0.09	1.01	2.08	8.41
25	Food products nec	0.2	-0.47	-0.33	5.74	11.18
26	Beverages and tobacco products	0.11	1.23	2.05	7.93	9.81
27	Textiles	0.23	1.62	9.39	4.30	20.33
28	Wearing apparel	0.26	0.56	3.54	2.63	14.46
29	Leather products	0.17	1.27	7.22	1.87	10.16
30	Wood products	0.25	0.21	1.21	1.43	7.78
31	Paper products, publishing	0.15	0.15	0.86	0.74	3.65
32	Petroleum, coal products	0.07	0.28	0.94	0.46	1.48
33	Chemical,rubber,plastic prods	0.21	0.18	1.10	0.89	5.02
34	Mineral products nec	0.17	0.60	2.93	1.51	7.20
35	Ferrous metals	0.11	0.12	0.71	1.69	6.93
36	Metals nec	0.03	0.12	0.59	0.32	1.81
37	Metal products	0.15	0.08	0.77	0.78	3.81
38	Motor vehicles and parts	0.13	0.09	0.71	0.63	2.95
39	Transport equipment nec	0.08	0.05	0.42	0.41	2.02
40	Electronic equipment	0.08	0.05	0.45	0.40	1.98
41	Machinery and equipment nec	0.13	0.07	0.69	0.60	3.20
42	Manufactures nec	0.12	0.09	0.73	0.63	3.25
43	Electricity	0.36	-0.41	-0.22	-0.60	11.10
44	Gas manufacture, distribution	0.14	0.00	0.75	0.62	3.47
45	Water	0.27	0.17	1.08	0.75	3.99
46	Construction	0.1	0.03	0.39	0.49	2.35
47	Trade	0.13	0.05	0.70	0.52	2.80
48	Transport nec	0.11	0.06	0.56	0.45	2.29
49	Sea transport	0.07	0.07	0.44	0.30	1.44
50	Air transport	0.06	0.07	0.38	0.27	1.22
51	Communication	0.1	0.07	0.58	0.46	2.35
52	Financial services nec	0.12	0.09	0.68	0.54	2.65
53	Insurance	0.11	0.09	0.61	0.55	2.55
54	Business services nec	0.03	0.05	0.28	0.20	0.99
55	Recreation and other services	0.1	0.10	0.61	0.45	2.12
56	PubAdmin/Defence/Health/Educat	0.03	0.06	0.18	0.14	0.53
57	Dwellings	-	-	-	-	-
	Total	0.1	0.53	1.44	1.13	3.58

Source: GTAP simulation

Table 19: Impacts on India's Exports under Different Scenarios
(% Change in Export from Base)

S. No.	Sectors	MFN	MFN + IND-PAK FTA	MFN + IND-PAK FTA with bilateral TF	MFN + SAFTA	MFN + SAFTA with regional TF
1	Paddy rice	-0.39	2.75	2.22	3.41	5.48
2	Wheat	5.87	15.37	29.58	23.81	324.21
3	Cereal grains nec	-0.06	0.29	0.32	3.72	5.97
4	Vegetables, fruit, nuts	-0.02	1.92	5.32	10.73	25.58
5	Oil seeds	1.28	1.10	0.64	3.33	5.29
6	Sugar cane, sugar beet	-1.24	-0.63	-2.18	8.33	48.72
7	Plant-based fibers	-0.15	4.43	19.78	3.43	16.25
8	Crops nec	-0.01	3.43	10.49	9.90	29.76
9	Cattle,sheep,goats,horses	0.66	0.85	2.05	27.53	100.46
10	Animal products nec	0.26	0.70	1.06	1.68	4.57
11	Raw milk	2.19	2.33	1.97	0.66	-5.78
12	Wool, silk-worm cocoons	-0.74	1.94	2.49	-1.28	-9.49
13	Forestry	0.52	10.28	19.42	9.16	19.90
14	Fishing	-0.15	-0.17	-0.71	0.10	1.19
15	Coal	0.07	-0.02	0.00	13.50	50.28
16	Oil	2.52	-1.76	-2.78	0.00	506.23
17	Gas	-	-	-	-	71.50
18	Minerals nec	0.05	0.05	-0.01	0.03	-0.34
19	Meat: cattle,sheep,goats,horse	6.59	4.46	9.01	3.34	2.44
20	Meat products nec	2.77	5.86	23.96	10.00	102.91
21	Vegetable oils and fats	2.73	5.96	23.75	7.31	35.75
22	Dairy products	0.31	5.41	19.74	26.04	91.39
23	Processed rice	0.01	0.52	0.24	3.82	14.97
24	Sugar	0.28	3.96	11.06	12.42	25.68
25	Food products nec	-0.01	2.17	3.54	3.14	5.15
26	Beverages and tobacco products	0.03	0.13	-0.09	15.13	24.73
27	Textiles	-0.1	0.47	0.51	3.02	10.09
28	Wearing apparel	-0.29	0.02	-1.16	-0.70	-3.10
29	Leather products	-0.12	1.65	3.66	0.78	0.05
30	Wood products	-0.23	-0.20	-1.58	1.34	7.10
31	Paper products, publishing	1.14	1.46	5.81	10.22	42.53
32	Petroleum, coal products	0.1	1.01	2.92	2.79	5.90
33	Chemical,rubber,plastic prods	1.49	2.54	9.65	3.84	16.54
34	Mineral products nec	-0.04	0.45	1.02	2.23	6.41
35	Ferrous metals	0.12	0.34	1.16	0.98	4.56
36	Metals nec	0.05	0.26	0.94	-0.22	1.72
37	Metal products	-0.2	0.99	2.96	2.22	9.13
38	Motor vehicles and parts	-0.08	-0.03	-0.85	4.99	8.86
39	Transport equipment nec	-0.03	0.07	-0.15	8.43	28.13
40	Electronic equipment	-0.22	-0.13	-1.41	1.56	12.74
41	Machinery and equipment nec	-0.06	0.25	1.26	0.86	8.31
42	Manufactures nec	-0.3	-0.11	-1.36	-0.97	-4.89
43	Electricity	-0.07	-0.06	-1.09	0.94	35.38
44	Gas manufacture, distribution	4.28	4.37	2.82	0.00	-6.60

S. No.	Sectors	MFN	MFN + IND-PAK FTA	MFN + IND-PAK FTA with bilateral TF	MFN + SAFTA	MFN + SAFTA with regional TF
45	Water	-1.04	-0.92	-1.95	-1.67	-5.07
46	Construction	-0.16	-0.07	-0.74	-0.63	-3.00
47	Trade	-0.19	-0.02	-0.78	-0.71	-3.57
48	Transport nec	-0.14	-0.05	-0.52	-0.55	-2.40
49	Sea transport	-0.13	-0.06	-0.65	-0.58	-2.35
50	Air transport	-0.15	-0.07	-0.58	-0.59	-2.43
51	Communication	-0.17	-0.11	-0.83	-0.74	-3.36
52	Financial services nec	-0.18	-0.12	-0.94	-0.82	-3.83
53	Insurance	-0.18	-0.11	-0.88	-0.77	-3.38
54	Business services nec	-0.16	-0.10	-0.63	-0.70	-3.14
55	Recreation and other services	-0.17	-0.11	-0.89	-0.72	-3.44
56	PubAdmin/Defence/Health/Educat	-0.17	-0.08	-0.71	-0.71	-3.14
57	Dwellings	-	-	-	-	-
	Total	0.12	0.64	1.78	1.36	4.32

Source: GTAP simulation

To conclude, Pakistan's MFN to India would generate larger benefits if it is supported by improved connectivity and trade facilitation.³¹ The net economic impacts of SAFTA along with trade facilitation are beneficial to both Pakistan and India, and eventually would lead to stronger economic growth of the entire South Asian region. With Pakistan's MFN to India, the full implementation of SAFTA is therefore not beyond our reach. Both the countries should therefore go beyond MFN and embrace to a second generation FTA that would open the door to other regional cooperation initiatives. At the same time, investments from India could provide a major boost to Pakistan's export industry, which in turn would reduce its trade gaps with India and other countries in the world.

5. Role of FDI in Narrowing Pakistan's Trade Gap with India

Developing countries and emerging economies identify FDI as a source of economic development and growth.³² The developing countries hence make effort to attract FDI by pursuing policies to liberalize the investment regimes and to ensure the maximum benefits of the domestic economy.³³ FDI facilitates international trade, helps in transferring of technology and encourages specialization, which in turn increase in productivity (Ramírez, 2006). FDI increases the rate of technical progress in the host country through a 'contagion' effect from the more advanced technology, management practices, etc. used by the foreign firms. In due course there is a technology transfer as the local workforce gains knowledge of the manufacturing processes and management practices. The value added in these industries is a

³¹ In an another study, Hertel and Mirza (2009) observed that trade facilitation plays an important role in determining patterns of global trade flows, where the relative effect on bilateral trade of improving an exporter's border logistics is larger than that of improving an importer's trade facilitation. The study also revealed that proportionate increases in intra-South Asia trade are larger in all countries for textiles and clothing, automobiles and their parts, and other manufacturing goods.

³² FDI is an important vehicle for contributing relatively more to growth than domestic investment (Borensztein, 1998). Blomstrom et al. (1992) also found a strong effect of FDI on economic growth in LDCs.

³³ FDI is usually preferred to other forms of external finance because they are non-debt creating, non-volatile and their returns depend on the performance of the projects financed by the investors.

contribution to GDP and foreign exchange earnings. Therefore, FDI contributes to foreign exchange earnings, employment creation and increases in incomes for the economy. But to attract FDI, a congenial investment climate is to be ensured. Consistent macroeconomic policies, good governance, economic stability, guarantee of property rights, rule of law and absence of corruption are among the conditions required to attract FDI. Consistency and predictability in economic policies and political stability are preconditions to attract FDI. There has been a long-standing complain from Pakistan that the huge imbalance in trade with India was affecting steps to improve economic relations and the sprout of beneficial mutual investment. In a world of increased competition and rapid technological change, FDI's role is thus very valuable. FDI helps narrow the trade gap between countries or regions.

Table 20. FDI Inflows in Last Three Decades

	1980-1989		1990-1999		2000-2009	
	Inward FDI	Share in World	Inward FDI	Share in World	Inward FDI	Share in World
	(% of GDP)	(%)	(% of GDP)	(%)	(% of GDP)	(%)
China	0.63	1.83	3.91	6.24	3.09	6.26
India	0.02	0.11	0.39	0.35	1.54	1.13
Pakistan	0.33	0.12	0.88	0.15	1.78	0.16
South Asia	0.08	0.29	0.45	0.55	1.52	1.37
World	0.67	100	1.48	100	2.85	100

Note: FDI inflows counts net inflows, and its share in world FDI inflow

Source: UNCTAD Stat

Table 21. FDI Inflows and Outflows (US\$ billion)

	Inward FDI		Outward FDI	
	India	Pakistan	India	Pakistan
2000	3.588	0.309	0.514	0.011
2001	5.478	0.383	1.397	0.031
2002	5.630	0.823	1.678	0.028
2003	4.321	0.534	1.876	0.019
2004	5.778	1.118	2.175	0.056
2005	7.622	2.201	2.985	0.045
2006	20.328	4.273	14.285	0.109
2007	25.350	5.590	17.234	0.098
2008	42.546	5.438	19.397	0.049
2009	35.649	2.338	15.929	0.071
2010	24.640	2.016	14.626	0.046

Source: UNCTAD Stat

Despite of huge inflow of FDI towards developing countries, particularly in China and India, inflow of FDI in Pakistan has not been impressive. During 2000s, Pakistan accounted for 0.16 percent of world FDI, increased marginally over the last two decades, but always remained lower than the South Asian average (Table 20). India, on the other, could successfully increase its share in global FDI inflows to over 1 percent in 2000s from a meager 0.11 percent in 1980s. The size of FDI inflows in Pakistan was not significant till beginning of the last decade, when the FDI inflow increased sharply (Table 20). However, the 1980s was a good decade for Pakistan in which it outperformed neighboring India in attracting FDI. On average 149 percent of India's total FDI inflow went into Pakistan, which in later periods

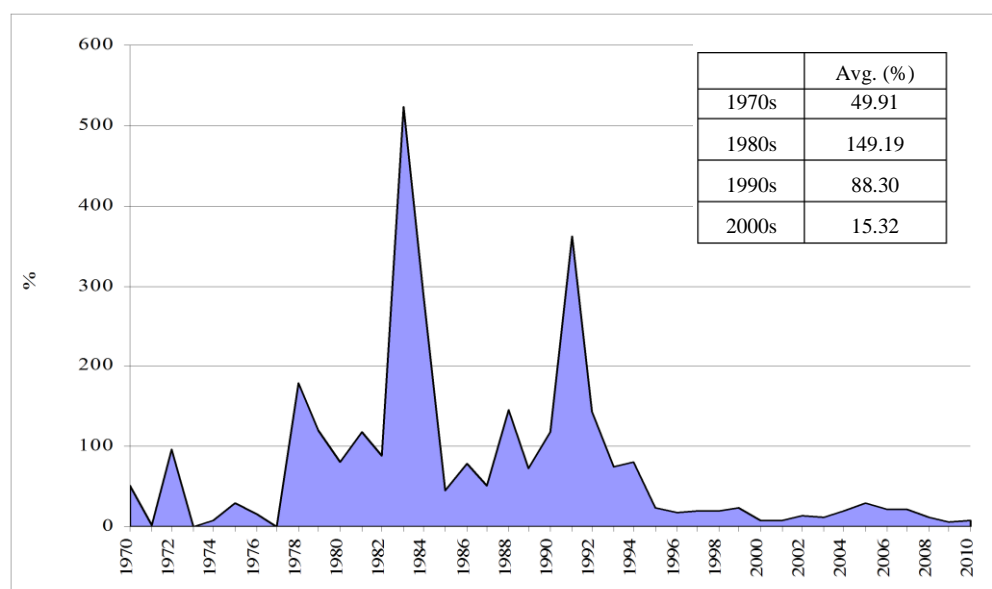
subsidized (Figure 4). At present, FDI inflow contributes to about 1.78 percent of GDP in Pakistan and 1.54 percent in India, but remained consistently lower than the Chinese and world average (Table 20). On the positive side, India and Pakistan witnessed sharp rise in FDI inflow in the last decade. Table 21 shows FDI inflow to India increased from US\$ 3.59 billion in 2000 to US\$ 24.64 billion with a peak of US\$ 52.55 billion in 2008, whereas a little over US\$ 2 billion FDI had flown to Pakistan in 2010, increased from less than half a billion in 2000. However, FDI in both the countries has showed a declining trend since 2008.

Table 22. Top 10 Sectors Attracting FDI during 2000-2010 (US\$ million)

Pakistan		India	
Sectors	Volume	Sectors	Volume
Communication (IT & Telecom)	7375.80	Telecommunications	12546.09
Financial Business	4929.30	Computer software and hardware	10997.13
Others	4666.90	Housing and real estate	10932.53
Oil & Gas	4452.30	Construction activities	10239.18
Trade	976.80	Drugs and pharmaceuticals	9196.54
Power	918.40	Power	7136.46
Construction	709.00	Automobile industry	6601.12
Transport	626.00	Metallurgical industries	5761.36
Chemical	588.50	Hotel & tourism	3195.70
Textiles	350.10	Petroleum & natural gas	3334.83

Sources: DIPP, India and State Bank of Pakistan

Figure 4. Pakistan's FDI Inflow as Percent of India's FDI Inflow



Source: Calculated based on UNCTAD Stat

The inflow of FDI into Pakistan is small and concentrated only in a few sectors, mostly in the communication, financial services and power (Table 22).³⁴ Broadly, manufacturing industries, mining and quarrying, and financial sectors are the major sectors dominated the FDI inflow in

³⁴ Appendix 5 captures economic group-wise break-ups of FDI inflows in Pakistan for 2011-12 FY.

Pakistan. On the other, a large number of sectors have been attracting FDI in India. The sectoral compositions of FDI in Pakistan and India have also changed overtime.³⁵ Although FDI inflow to India and Pakistan shows wide variations in level, both of them show some similarities. First, communication sector occupies top position in both the countries in FDI inflow. While Pakistan attracted US\$ 7.36 billion FDI in communication sector during 2000-2010, about US\$ 12.55 billion went into India in telecommunication sector in the same period. Power, oil and gas, and construction are other common sectors in India and Pakistan receiving FDI. Services, automobile, metallurgical, drugs and pharmaceuticals, and computer software and hardware sectors in India have also attracted modest FDI in the last decade. Incidentally, these are India's prime export sectors. Second, Mauritius and USA have been the largest direct investors in both India and Pakistan, respectively. Among countries, USA, UAE, Switzerland, Japan and Germany are major common investors in both the countries (Table 23).

Table 23. Top Ten Investors during 2000-2010 (US\$ million)

Pakistan		India	
Country	Volume	Country	Volume
USA	5688.50	Mauritius	62658.31
UAE	4085.30	Singapore	15895.36
UK	3075.50	Japan	12109.86
Switzerland	1396.10	USA	10472.81
China	793.40	Ukraine	9228.65
Hong Kong	780.00	Netherlands	6792.23
Norway	550.20	Cyprus	5839.09
Japan	463.50	Germany	4404.34
Germany	392.80	France	2719.21
Saudi Arabia	320.50	UAE	2091.46
South Korea	51.60	Switzerland	2047.10

Sources: DIPP, India and State Bank of Pakistan

South Asian economies have great potential to attract FDI. However, except India, all other countries actually attract very low amount of FDI. A number of policy and regulatory measures were taken to improve the investment climate and attract foreign investment in most of the South Asian countries. For example, restrictions on capital inflows and outflows were gradually lifted across South Asian countries. In spite of liberalising its formerly inward-looking FDI regime, tempering or removal of obstacles to foreign investors, performances of most of the South Asian, barring perhaps India, countries in attracting FDI have been lackluster, volatile and unpredictable. Many believe that major investment hurdles in South Asia are widespread corruption, poor governance, weak political and institutional structure, which are creating gap between policies and their implementations in these economies. Domestic business environment needs drastic improvement. Still starting a business takes about 3 weeks in Pakistan and about a month in India (Table 24). Countries show wide variation in starting a business in terms of procedures (coefficients of variation (CV) increased over time). The time involved in starting a business is relatively less dispersed and witnessed

³⁵ In India, foreign investments are currently permitted through financial collaborations, through private equity or preferential allotments and in joint ventures. FDI is not permitted in the arms, nuclear, railway, coal or mining industries.

fall during 2005 and 2011, as per the CV presented in Table 24.³⁶ Some of the South Asian countries performances in starting a business in terms of procedures and time are found to be better than a few prominent East Asian countries such as in China. Nonetheless, countries irrespective of regions need drastic improvement in cutting procedures required to start a business. Unilateral reforms in business facilitation by cutting investment procedures and processes would help strengthen the FDI environment. Countries in South Asia have been taken unilateral measures to reverse the declining trend of FDI, but success to date is limited to some sectors and that too in India. For example, by simplifying measures in banking and financial sectors, India has been attempting to restart the stalled reform processes.³⁷ Overall, the results have been so far mixed.

Table 24. Starting a Business – Time and Procedures

	Starting a Business - Procedures (number)		Starting a Business – Time (days)	
	2005+	2011#	2005+	2011#
Bangladesh	8	7	50	19
China	13	14	48	38
India	11	12	71	29
Indonesia	12	8	151	45
Malaysia	10	4	37	6
Nepal	7	7	31	29
Pakistan	11	10	24	21
Philippines	17	15	47	35
Sri Lanka	8	4	50	35
Thailand	8	5	33	29
Vietnam	11	9	50	44
Average	11	9	54	30
CV*	0.26	0.42	0.61	0.36

Note: *Coefficient of variation. +Reported in DBD 2006. #Reported in DBD 2012

Source: Calculated based on Doing Business Database (DBD), World Bank

In recent years, emerging market economies such as BRICS countries are increasingly becoming a source of foreign investment for rest of the world. It is not only a sign of their increasing participation in the global economy but also of their increasing competence. More importantly, a growing impetus for change today is coming from developing countries and economies in transition, where a number of enterprises are increasingly undertaking outward expansion through FDI. Companies are expanding their business operations by investing overseas with a view to acquiring a regional and global reach. For example, India has emerged as one of the key investors in the world. Outward FDI from India increased in tandem from half a billion US\$ in 2000 to US\$ 14.63 billion in 2010 with a peak of US\$ 19.40 billion in 2009, with most of the outgo being in the form of guarantees to offshore investment companies. In recent years, Indian firms continue to invest aggressively in foreign

³⁶ Distributions with $CV < 1$ are considered low-variance, while those with $CV > 1$ are considered high-variance. Between any two variables, the variable with the smaller CV is less dispersed than the variable with the larger CV.

³⁷ Differences in political ideologies of the coalition parties of the present government were identified as a major cause for slowing down the FDI inflow in India in recent years. While Indian Cabinet had proposed 51 percent FDI on multi-brand retail, with conditions, decision has been suspended due to lack of political consensus. Amendment bill introduced in Indian Upper House of the Parliament for raising the FDI limit in insurance sector from 21 percent to 49 percent, government is yet to decide on the matter. Similarly, the government is yet to take a decision on foreign airlines to pick-up stake in India's airlines.

destinations to explore new markets and also increase their global footprint, while taking advantage of the attractive valuations of assets overseas. But, no single Indian firm has any commercial presence in Pakistan. There is no denying that Indian FDI is important for Pakistan for many reasons, and one would certainly be to narrow Pakistan's trade gap with India.³⁸

(a) Barriers and Constraints to Bilateral FDI

While India and Pakistan have succeeded in attracting FDI from the world, there exists hardly any investment between the two neighbours. Pakistan has long been complaining about the Indian government's policy that bars its industry from making investments in India. India did not allow FDI from Pakistan until recently.³⁹ There has been demand from Pakistan to allow investments to India but the proposal did not find many takers within the government due mainly to security concerns. On the other, Pakistan does not have any major restriction on Indian investments. Still, Indian companies have not made any investment in Pakistan. In both the cases of services trade and FDI, prior government approval however has to be obtained, and it is clear that such approvals have been granted very sparingly by either country.

At present, there are no joint ventures between India and Pakistan. Institutional mechanisms for bilateral investment guarantees are yet to be established. There is considerable lack of information and awareness in India about Pakistan's trade regime, commercial policies and business and regulatory procedures. In recent period, Indian companies have shown interests in floating joint ventures in Pakistan and have asked the two governments to set up an institutional mechanism that would guarantee protection to each other's investments. Companies from Pakistan are also showing interests for investment in India.⁴⁰ As several companies are showing interests to invest in each other's country, it is imperative to understand the nature of such investment and provide timely facilitation.

(b) Measures to Strengthen Bilateral FDI

There is a complementary (joint) impact of institutions and openness on FDI.⁴¹ Several empirical studies support the view that institutional quality is an important determinant of FDI and believe a healthy institutional environment, i.e. efficient bureaucracy, low corruption, better law and order condition and secure property rights is important to enhance the FDI in developing economies.⁴² When rising protectionism is slowing down openness amid global financial crisis, strengthening institutions and governance perhaps would help the South Asian countries to increase the FDI inflow.

³⁸ Refer, the joint press conference (on 15 February, 2012). With his Pakistan counterpart, Indian Commerce, Industry and Textiles Minister Anand Sharma (Sharma is the first Indian commerce minister to visit Pakistan after independence. He arrived through the Attari-Wagah border, accompanied by a 150-strong business delegation) had told press reporters on, "The question of investment becomes relevant as economic engagement between the two countries deepens. The concerns expressed (by Pakistan) on investment have been seriously taken on board would take an appropriate and correct view soon".

³⁹ There used to be a negative list of countries under the Foreign Exchange Management Act (FEMA) in India. The government deleted Sri Lanka in 2006, Bangladesh in 2007 and Pakistan in 2012 from the list.

⁴⁰ For example, Pakistan's largest cement make, Lucky Cement, is planning to invest in India (refer, The Mint, dated 23 November 2012)

⁴¹ Refer, for example, Dollar and Kraay (2003).

⁴² However, many studies have failed to establish significant relationship between institution and FDI. The literature reveals evidence of significant association between institutions quality and FDI remains mixed. Refer, for example, Lim (2001), Blonigen (2005).

Correcting the investment environment and political relation is the most important measures for bilateral FDI between India and Pakistan. Physical and technological infrastructures are also needed to be developed, more importantly at the border check-posts. The poor state of infrastructure acts as a serious bottleneck for not only exports but also foreign investment.⁴³ Improving labour market conditions and administrative capabilities are also important to induce higher levels of foreign investment. Easier travel rules for the business people should also be enacted. There should be a proactive policy for promoting investment through joint ventures in both countries, market access for banks in each other's market, etc. At the same time, institution to deal with investment-related grievances along with transparent rules and regulations should be set-up. Improving border trade infrastructure and mutual recognition agreements (MRAs) to facilitate movement of goods is also very important. In September 2012, both India and Pakistan have taken steps to ease visa restrictions for increased travel between the two countries. Both countries have agreed to allow one-year multiple entry visas for business visitors and entry and exit through different cities. Both the central banks – State Bank of Pakistan and Reserve Bank of India – had finalized a deal to open up banking outlets in each other's country which would reduce the transaction cost of trade and facilitate FDI.⁴⁴ These steps are perceived as fruitful ways and means to boost business sentiments and bilateral relation.

(c) Industries to Benefit from Enhanced FDI

As India and Pakistan compete to sell their goods in the global market, there are many areas in which both the countries can complement each other's needs and hence produce cost-effective quality goods. According to the SCCI, investment possibilities in Pakistan exist in sectors such as food processing, chemicals and pharmaceuticals, automobile components, and information technology. In the recent past, a number of potential sectors for mutual cooperation between India and Pakistan has been identified, which include agricultural products, textile machinery industry, automobile industry, petrochemical industry, minerals, chemicals, pharmaceuticals, leather, telecommunications, etc.

India and Pakistan can also establish joint ventures to harness and transmit the region's hydropower resources. With a higher energy demand, there is potential for cooperation between India and Pakistan in electricity generation using coal or generation of wind energy. There is potential for tapping wind energy in the Sindh province of Pakistan, which could make use of wind power in cooperation with India. Cooperation in water management and power projects may help in increasing irrigation benefits, decreasing risks of floods, and establishing an India-Pakistan electric grid system for intra-country transmission of electricity. Both countries require large volumes of natural gas imports to meet their future domestic needs. A single, joint natural gas pipeline extending overland from Pakistan to India would be economically more viable for both the countries than constructing their respective pipelines independently.

⁴³ Refer to, for example, Amjad et al. (2012), which evaluated Pakistani exporters' perceptions of the problems they face in exploiting their full competitive potential in the international market. Using firm-level survey data, they found that a shortage of skilled labour, the energy crisis, institutional rigidities, market imperfections, and weaknesses in physical infrastructure have been the key impediments to achieving export competitiveness.

⁴⁴ From India, Bank of India and State Bank of India and from Pakistan, National Bank of Pakistan and United Bank are likely to open branches in Pakistan and India, respectively.

(d) Recent Progress in FDI

Both the governments plan to restart investment flows, and have made notable progress in reinstating a favorable climate. With political and economic stability, India and Pakistan can expect fresh foreign investment coming into these countries. In recent time, an atmosphere of cooperation and amicability is flowing between in India and Pakistan, and both countries are trying to improve their bilateral trade relations which would improve the security climate for investment. As a part of the broader process of regional integration as an economy with larger access to regional markets becomes more attractive to foreign investors. Greater inflow of FDI, in turn, may lead to increased technology transfer and productivity. These steps would greatly expand the scope of integration, with potentially large efficiency gains on both sides.

The Indian government has amended the FEMA Act, which has paved the way for investment from Pakistan. Subsequently, FEMA rules were also amended. Investment from Pakistan is now allowed except defence, space and atomic energy sectors. However, the proposals for investment in India by companies from Pakistan would be routed only through the Foreign Investment Promotion Board (FIPB) route and not through other channels. It is expected that FDI from Pakistan to India will be slow since companies might wait and watch the overall political progress before making any commercial decision. At the same time, this is not to deny that compared to recent past, the current progress in FDI has been very healthy.

India and Pakistan have agreed to develop mechanisms to address trade and investment issues. The 5th Round of Commerce Secretary Level Talks between held on 27 -28 April 2011 had discussed trade promotional options. The discussion progressed further at the 6th and 7th Rounds of Commerce Secretary Level Talks, held on 14-16 November 2011 and 20-21 September 2012, respectively. The concerned authorities, trade bodies and associations have suggested that the Pakistani government should consciously relax the conditions on Indian investment. It was also clarified that there would be no harm to the indigenous industry if an industry was established by both Pakistani and Indian companies, having 50 percent share by each party. The opening of investment would not result in a deluge of money flowing across both sides of the border. Nonetheless, closer economic cooperation will lead to positive political gains.

6. Ways to Facilitate Bilateral Trade and Policy Options: Some Recommendations

Normal trade between India and Pakistan will place peace on the fast track. This is not to deny that there were disruptions in the past, but have become shorter-lived.⁴⁵ Some recent studies show that trade between the two countries may touch US\$ 12 billion by 2015, if trade and investment barriers are removed.⁴⁶ To achieve this, we have to strengthen the peace process and continue our interactions. “Dividends” is yet another effort to nudge the two countries to keep the economy high up on the agenda. Undoubtedly, normal relation between the two countries offers huge peace dividends. It offers great opportunity for a new era on integration.

⁴⁵ Refer, Appendix 6, which presents trends in BSE SENSEX for three cases: (i) SENSEX just days after Kargil War in 1999, (ii) SENSEX at the time of Indian Parliament attack in 2001; and (ii) SENSEX after Mumbai blasts in 2008. SENSEX had fallen drastically soon after the incidents in all the three cases and damaged the economic gains.

⁴⁶ Refer, for example, De, Raihan and Ghani (2012).

While the going is good, both governments must be much more ambitious. Pakistan needs to focus on improving customs and scrapping the remaining negative list on trade. But India, which stands to gain disproportionately from burgeoning trade, must take bigger responsibilities. Stable relations with Pakistan are a prize in itself for the Indians. Immense hurdles remain, not least the quest for peace in Afghanistan; but the longer-term dream is of land trade through Pakistan to Central Asia, with its oil and gas, and even to European markets. Given all that, India should dare to be generous, removing non-tariff barriers, cutting duties on Pakistani imports and making it easier to invest in India. Important steps at the border today will bring great rewards in future. However, the progress is so far impressive (see Box 2).

Box 2. Normalization of Trade Relations: Some Recent Developments

The prospects of higher trade between India and Pakistan seem to be brighter than ever as current governments of both countries have shown political will for it, particularly when Pakistan agreed to extend MFN status to India. Unlike previous occasions, trade talk between the two countries is headed with a time line and managed professionally. The issues pertaining to commercial and economic cooperation are discussed at the Commerce Secretary level within the framework of the Musharraf-Singh “Composite Dialogue”. Till date, 7th Round of Commerce Secretary level talk was held on 20-21 September 2012 at Islamabad.

Pakistan recognised that grant of MFN status to India would help in expanding bilateral trade relations. The transition towards full normalization of trade relations with India was initiated by moving from a ‘positive list’ regime to a ‘negative list’ regime. Pakistan has already notified its negative list on 20th March 2012. The understanding at the previous Ministerial level talks has been that after approval by the Cabinet this negative list would be dismantled before the end of 2012.

Commerce Secretaries of both the countries agreed that better trading opportunities provided through land route would enhance mutual prosperity of the business communities and consumers of both sides of the border. They, however, have noted that there is need to further strengthen the infrastructure on both sides. Both the governments have directed the customs and the port authorities to resolve all the issues through mutual cooperation, harmonisation of customs procedures, provision of laboratory facilities, scanners, weigh bridges, cold houses, containerised services and automation of the business processes. For this purpose, meetings of the Customs Liaison Border Committee (CLBC) would be held on monthly basis. CLBC would also explore the possibilities of organising meetings between the relevant importers and exporters at Wagah-Attari border. It was decided that Wagah-Attari customs stations would operate seven days a week.

The need for more trade traffic to be carried through the Railways was emphasized at the 7th Round of Commerce Secretary level meeting. For this purpose, it was agreed that the Railway Ministries would hold joint coordination meetings on a monthly basis, at the appropriate levels. Issues on availability of sufficient number of rakes for interchange was also highlighted by the Pakistan Railways. It was noted that the earlier agreed provision of 3-4 interchanges a day has not been adhered to due to current trade patterns. A viable solution is to allow High Capacity Wagons (HCW) from Pakistan which would carry three times more load than the regular wagons. The Indian Railways agreed that specifications already provided by the Pakistan Railways for HCW would be examined and conveyed accordingly.

Trade regulations, standards, labeling and marking requirements are also identified as key issues for bilateral cooperation. During the 6th Round of Commerce Secretary level meeting, held on 14-16 November 2011 at New Delhi, India and Pakistan have agreed to develop mechanisms to address issues of Non-Tariff Barriers (NTBs). At the 7th Round of Commerce Secretary level meeting, Pakistan government highlighted that certifications/ licensing/ lab testing/ are not the only NTBs but issues like delays in customs clearance, non availability of railway wagons for cargo transport,

absence of direct flights or any problem which delays the clearance of goods with no end results or change, faced by importer/exporter is an NTB. The two countries have signed three agreements relating to trade i.e., Customs Cooperation Agreement, Mutual Recognition Agreement and Redressal of Trade Grievances Agreement to build confidence of the business community on both sides. Through implementation of these Agreements the two countries will systematically address the issues related to NTBs. It was also agreed at the 7th Round of Commerce Secretary level meeting that on the same pattern as Mutual Recognition Agreement (MRA) between BIS and PSQCA, another agreement between Export Inspection Council of India (EIC) and PSQCA will be signed. Both sides have already exchanged the draft texts and it was agreed to complete the internal approvals before the next meeting of the Commerce Secretaries. Previously, in November 2011, following four agreements were signed between them: (i) New Business Visa Agreement, (ii) Customs Cooperation Agreement (information, data, harmonization), (iii) Mutual Recognition Agreement (standards—health, cement, textiles as India features non-WTO standards), and (iv) Redressal of Grievances Agreement (commercial disputes resolution mechanism), and in September 2012, India and Pakistan have signed agreement for facilitation of visa. Once implemented, the new Visa Agreement will liberalise the bilateral visa regime and introduce a number of measures aimed at easing travel, including travel for business purposes. The new Agreement has still not come into force. Pakistan needs to indicate its readiness to bring into force the new Visa Agreement.

On exploring the possibilities of opening new land routes for trade, Pakistan government has informed that a working group on Munabhao-Khokhrapar has been constituted. Indian government has already conveyed constitution of working group. Opening of this route would depend on the recommendations of the working groups.

Pakistan government expressed appreciation of the steps taken by India to reduce its SAFTA sensitive list by 30 percent from 878 tariff lines to 614 tariff lines as agreed earlier during the 6th Round of Talks. The Indian side explained that out of 264 tariff lines which have been removed from India's SAFTA sensitive list, 155 tariff lines pertain to agricultural commodities and 106 tariff lines relate to textile items. To further deepen the preferential arrangements under SAFTA and to provide level playing field to Pakistani exporters in comparison to concessions allowed by India under SAFTA to rest of the countries in the SAARC region, both sides developed a long term plan. It was noted that Pakistan now has a total of 936 tariff lines at 6-digit under its SAFTA Sensitive List, as against 614 tariff lines at 6 digit of India. It was agreed that after Pakistan has notified its removal of all restrictions on trade by Wagah-Attari land route, the Indian side would bring down its SAFTA sensitive list by 30 percent before December, 2012 keeping in view Pakistan's export interests. Pakistan would transition fully to MFN (non discriminatory) status for India by December 2012 as agreed earlier. India would thereafter bring down its SAFTA Sensitive List to 100 tariff lines at 6 digit level by April, 2013. As India notifies the reduced Sensitive List, Pakistan, after seeking approval of the Cabinet, will also simultaneously notify its dates of transition to bring down its SAFTA sensitive list to a maximum of 100 tariff lines at 6 digit level within next 5 years. The reductions shall be notified by Pakistan in equal measure for each year so as to complete reduction to 100 lines before end of 2017. Thus, before the end of 2017, both India and Pakistan would have no more than 100 (6 digit) tariff lines in their respective SAFTA sensitive lists. Before the end of year 2020, except for this small number of tariff lines under respective SAFTA sensitive lists, the peak tariff rate for all other tariff lines would not be more than 5 percent.

The Commerce Secretaries also reviewed the progress on other issues such as enhanced trade for petroleum products, trade in power and reciprocal opening of Bank branches. Based on this review, the Commerce Secretaries exhorted the relevant stakeholders on both sides to speed up the mutual consultations so that concrete progress is achieved within the next six months. During this review, Indian side informed its willingness to consider export of gas up to 5 million cubic metres per day, for an initial period of five years. Pakistan side informed that India's offer has been received and is under active consideration. BHEL (an Indian PSU) made an offer to cooperate with the Pakistan side in setting up 500 – 2000 MW capacity in coal/hydro or Gas power plants, as per their requirements. Indian side indicated its willingness to cooperate with Pakistan in areas of wind and solar energy.

Indian side also made an offer for meeting the requirements of Pakistan Railways for up to 100 locomotives.

Pakistan government has emphasised the importance of taking SMEs along in this trade normalisation process. It highlighted that sectors like surgical instruments, cutlery, fans, leather and marble products have a huge potential for trade. It was agreed that an institutional mechanism would be constituted to work out exhibitions of these products in India. Sharing of technology, skill development, training and collaboration in development of designs would also be encouraged. Cooperation in the manufacturing activities of the Gems and Jewellery sector would be actively encouraged.

Civil Aviation Authorities of both the countries undertook discussions to ensure better air connectivity between New Delhi and Islamabad. It was noted that against an average of about 23 flights per week between New Delhi and other important national capitals of the SAARC countries, there is as yet no direct air connectivity between New Delhi and Islamabad. It was agreed that a Joint Working Group (JWG) would be formed, which would work out a more liberalised regime of reciprocal bilateral rights for commercial flights, to ensure economic viability of this air route. This JWG would also explore mechanisms for more efficient courier services.

Preliminary discussions were also held on possibilities of better telecommunication linkages keeping in view the requirements of business communities on both sides for international roaming facilities. It was agreed that separate sub-groups on either side would take forward this dialogue. Commerce Secretaries would review thereafter.

Both sides also reviewed the earlier discussed possibilities of greater trade cooperation in sectors of agriculture and information technology. Relevant stakeholders would be encouraged to take forward economic cooperation in these areas. Cooperation for increasing cotton yield in Pakistan through trials of suitable Bt cotton seeds, would be given more focused attention

Source: Authors, compiled from various Statements of the Commerce Ministers Level Meetings between Pakistan and India

A battery of recent studies indicate India and Pakistan should activate further trade liberalisation in cutting list of sensitive products, removal of NTMs along with improvement in trade facilitation, and transit of goods and services.⁴⁷ So far, by replacing the positive list with negative list of trade, India and Pakistan have come relatively closer to reinstate a non-discriminatory trade regime. With MFN status, Pakistan will provide equal treatment to India in terms of tariffs and trade regulations that it offers to other WTO members. This will obviously encourage formal trade to grow, and informal and third country trade is expected to disappear gradually. At the same time, MFN treatment does not necessarily mean that the trade regime becomes preferential, open, or accessible. As trade flows between India and Pakistan increase, there would be greater demand for transparency, faster movement of goods and services across borders and higher market access. New solutions need to be worked out to ease NTBs. A step forward in this direction could mark the beginning of greater trade and economic cooperation between the two countries through MFN regime. A lot more needs to be accomplished before a free trade would give each country a stake in other's success.

What makes a MFN working is the trade facilitation that surrounds it. The results of the general equilibrium simulations indicate Pakistan's MFN to India would generate larger

⁴⁷ Gains for South Asian intraregional trade accruing from improvements in regulatory and logistical issues are huge (Wilson and Otsuki 2007). Also refer Taneja (2012), Kochhar (2012), Lopez-Calix (2012), Khan (2012), De et al. (2012), Pasha and Imran (2012), etc.

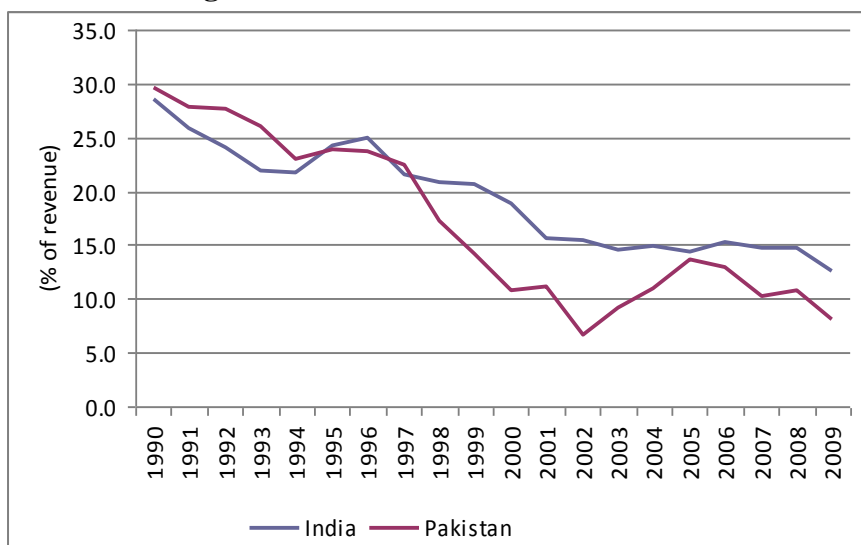
benefits if it is supported by improved connectivity and trade facilitation. In other words, gains to Pakistan would be limited in absence of improved connectivity and trade facilitation. The net economic impacts of SAFTA along with trade facilitation are beneficial to both Pakistan and India, and eventually would lead to stronger economic growth of the region. With Pakistan's MFN to India, the full implementation of SAFTA is therefore inevitable.

In general, three policy options are recommended. First, further deepening of trade liberalisation (e.g. removal of NTBs, cleaning the sensitive lists, DFQF access to products where marginal return from trade very high, removal of quantitative restrictions). Second, support trade facilitation to complement the trade liberalisation (e.g. remove the delay in payment between exporter and importer by introducing net banking, allow more banks to operate). Third, make the FDI flow move freely between the two nations (e.g. build the institutional mechanism for bilateral investment guarantee).

Option 1: Tariff rationalisation and removal of NTBs

Both the countries trade liberalisation initiatives over the past decade and a half have been deep as well as broad. Government's dependence on import duties has declined since 1990 in both India and Pakistan (Figure 5). Given that import tariffs introduce a bias against exporting, the large reductions in tariffs have played a role in improving the export competitiveness in India and Pakistan. Thus, customs duties are still the principal instrument of trade policy, particularly in context of India and Pakistan trade.

Figure 5. Taxes on International Trade



Source: Calculated based on World Bank WDI Online Database

Average tariff between India and Pakistan has come down much faster than that of non-tariff barriers in recent past. But, as shown in Figure 6, both countries feature large dispersion between - and within - statutory tariffs. For example, India's distribution more skewed to lower tariffs. Although average tariff has come down to 10-15 percent in both the countries, high tariffs still persist on some major products. For example, Pakistan's applied import tariff of 35 percent on Indian export of granite (contributing about 55 percent of Pakistan total import from world) or 20 percent on Condensers for steam or other vapour power units (contributing about 100 percent of Pakistan's import from world) have been penalizing the bilateral trade to grow. On the other, India's import tariff (AHS) of 24 percent on Pakistani

export of dates (edible fruits & nuts) appears to be on higher side. India imported about US\$ 35 million dates from Pakistan in 2009. India's tariffs are also relatively high on imports of textiles and agricultural products from Pakistan. India imposes both ad valorem rate and specific duty, whichever is higher, on import of textile and clothing and agricultural goods. Generally, the specific duties appear to be higher in India and, in some cases, exceed 100 percent, especially on value-added textiles. Compared to specific duty, ad valorem rates are much lower. India has also kept 243 items of textile and clothing sector as sensitive items under SAFTA (Table 25).⁴⁸ Appendix 8 presents Pakistan's and India's import tariffs on selected products on each other's exports. Quick gains can be obtained for reducing Indian tariffs on Pakistan cotton yarn, fruits and vegetables and removing NTBs. Similarly, freeing import of newsprint from India would help Pakistan to manage its huge shortfall in demand of newsprint. Therefore, pruning the sensitive lists and normalization of import tariffs may enhance bilateral trade.

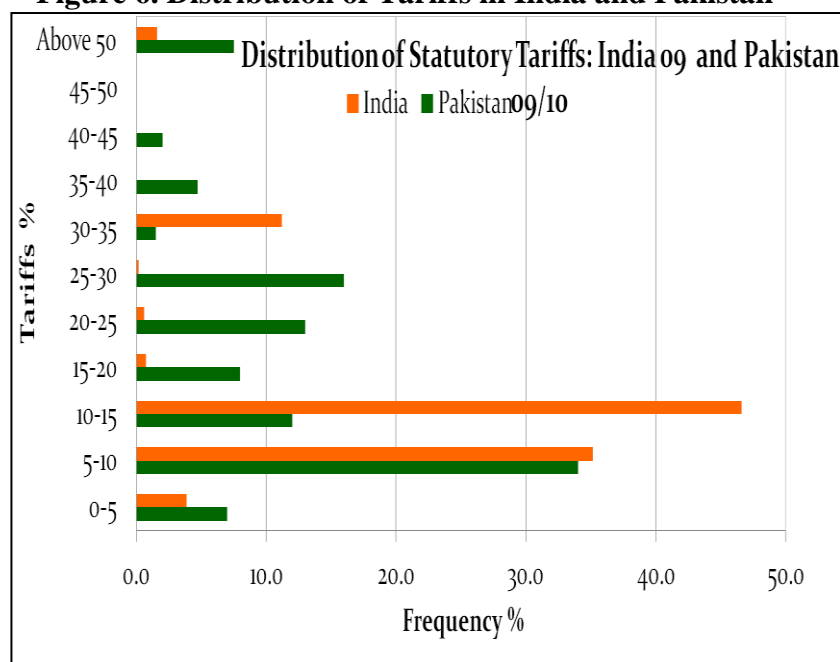
Table 25. Sensitive List of India in Textile and Clothing Sector under SAFTA for Non-LDCs

HS 2002	Commodity groups	Share*	Frequency
61	Articles of apparel and clothing	11.43	96
62	Articles of apparel and clothing	9.17	77
60	Knitted or crocheted fabrics	5.00	42
55	Man-made staple fibres	2.50	21
54	Man-made filaments; strip	0.60	5
58	Special woven fabrics; tufted textile	0.24	2
	Total	28.93	243

*Share in total items

Source: Calculated based on SAARC Secretariat

Figure 6. Distribution of Tariffs in India and Pakistan



Source: Adapted from Lopez-Calix (2012)

⁴⁸ Appendix 7 presents India's sensitive lists at HS 2 under SAFTA for non-LDCs

In addition to rationalising import duties, we should eliminate quantitative restrictions, regulatory duties, and other para-tariffs, and several other measures that have been restricting trade in the past. Despite the fall in average tariffs, trade restrictiveness of both India and Pakistan has been heavily triggered by the large volume of NTBs. In promoting trade between India and Pakistan, the major stumbling block is the presence of such NTBs.⁴⁹ Deeper cooperation between India and Pakistan can potentially result in significant reductions of these barriers.

Trade liberalisation has long been seen as an important element of sound economic policy and trade facilitation is a necessary step for achieving it. Trading more efficiently between India and Pakistan would likely to increase average incomes, providing more resources with which to tackle poverty.

Option 2. Trade facilitation and improvement in connectivity

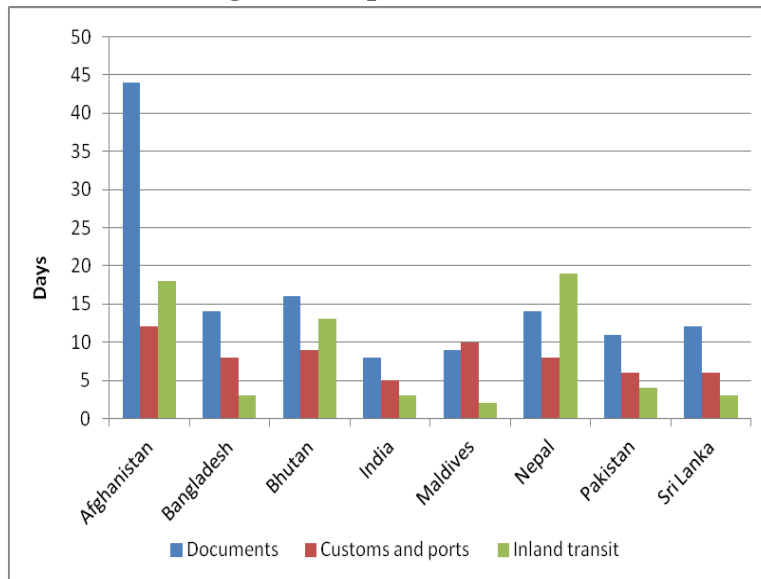
Trade facilitation is aimed at ensuring the movement and clearance of goods across borders within the shortest time at the minimum cost.⁵⁰ Thus, the two elements which form the crux of the issue are time and cost. Time itself has a cost besides the cost incurred in monetary terms. Trade facilitation would mean addressing these issues and attempting ways and means to minimise the cost and time taken for movement of import and export cargo.

Trade facilitation landscape of South Asia is unimpressive when we consider behind the border issues. India and Pakistan fair poorly with global peers in improvement in logistics. South Asian countries suffer from excessive direct costs and time taken to cross borders and from inefficiency in cross-border transactions, which ultimately affect trade negatively. Trade in the region is also constrained by poor condition of infrastructure, congestions, high costs, and lengthy delays. These problems are particularly acute at India-Pakistan border crossings, many of which pose significant barriers to trade. Among the major causes of high trade transaction costs is the number of cumbersome and complex cross-border trading practices, which also increase the possibility of corruption. Goods carried by road are subject largely to transshipment and manual checking at the border, which imposes serious impediments to regional and multilateral trade. The position is further compounded by lack of harmonisation of technical standards.

⁴⁹ This has been well recognized at the Ministerial level. Refer to Joint Declaration of 7th Ministerial Meeting Declaration, 20-21 September 2012.

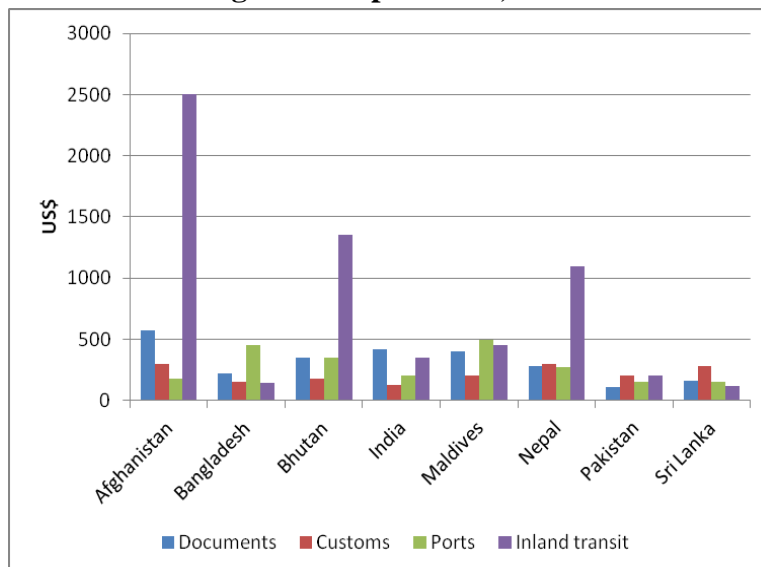
⁵⁰ The definition of trade facilitation in broader terms goes beyond what has been noted in the WTO. In literature, trade facilitation has been identified as the means to move trade across borders and not restricted to country's customs authority.

Figure 7. Export Time, 2011



Source: Doing Business Database, World Bank

Figure 8. Export Cost, 2011



Source: Doing Business Database, World Bank

The GTAP simulations show that improved trade facilitation (read, removal of behind the border barriers) would increase the volume of trade between India and Pakistan, by reducing the transaction costs of trade, making exports more competitive and imports less expensive. However, in reality, South Asian countries are much behind the global peers in trade facilitation. India has an edge over Pakistan in all dimensions of World Bank's logistics performance index.⁵¹ While larger economies such as India have successfully reduces the time taken to export, exporting a consignment in Pakistan still takes about 21 days (see Appendix 9). On the positive side, Pakistan beats India and other South Asian countries with lowest cost of exports in the region (Appendix 9). In case of export time, as shown in Figure 7, preparation of documents takes most of the times needed for export in South Asia except for Maldives and Nepal where time needed for customs and ports and inland transit,

⁵¹ This refers the year 2010. Source: World Bank Logistics Performance Index (LPI)

respectively, outweigh document preparation time. Therefore, reduction of transaction time through simplification of documentation and paperless trade should be the priority.⁵² Pakistan has the advantage of low cost of trading across the border in South Asia (Figure 8). However, other South Asian countries show relatively higher cost of export and import. Therefore, significant reductions in transaction costs in South Asia will be critical to the bilateral trade cooperation's effectiveness. To reduce trade-related transaction costs, governments must collaborate on a trade facilitation agenda that encompasses procedures, regulations and processes that impose costs on cross-border commercial transactions (e.g. customs, standards, movement of people, etc.).⁵³

Trade between India and Pakistan is expected to increase by manifolds in coming years. Accompanying this growth will be an increase in demand of both national and regional infrastructure services, for both production and consumption, and international trade purposes.. A failure to respond to this demand will slow down the trade between the two countries. Compared to their proximity, India and Pakistan do not have much presence of cross-border infrastructure between them and therefore circumvent much of the bilateral trade through unofficial routes. Thus, development of cross-border infrastructure, especially transportation linkages and energy pipelines, should get utmost priority, since completion of which will contribute to the bilateral as well as regional integration by reducing transportation costs and facilitating trade and services. With the MFN in trade, India and Pakistan should consider a strategy that will not only eliminate the barriers to cross-border infrastructure development but will also encourage investment flows in the region. Given that most cross-border projects are associated with several risks, India and Pakistan have to play a larger role in making an enabling environment for private sector to invest in regional infrastructure projects.

Transit in South Asia is long overdue. SAFTA may give Afghanistan an increased access to South Asian market. Similarly, the MFN agreement holds the potential for India and Pakistan to improve their connectivity with South West Asia, Central Asia and beyond. If goods are permitted to transit freely in South Asia, the whole region will benefit. Better trade relations with Pakistan can provide Indian goods transit access to Afghanistan and Central Asia in one hand, and to Iran and Turkey on the other. Pakistan has bilateral transit with Afghanistan, which was renewed in 2010. Besides, Pakistan is integral part of trade and transit arrangement in Economic Cooperation Organisation (ECO), which has helped Pakistan to run container train between Islamabad and Turkey via Tehran. In November 2006, Pakistan has signed an FTA with China, and in November 2008, the fast-track clearance for cross-border transit between China, Pakistan, Kazakhstan and Kyrgyzstan has commenced after 13 years

⁵² To support the trade flows between the two countries, India's Integrated Check Post (ICP) at Attari border, inaugurated on 13 April 2012, is a correct step forward. The setting up of the ICP is significant as it will naturally boost bilateral trade between the two countries. Built at a cost of nearly INR15 billion and spread over about 130 acres, the ICP has passenger and cargo terminals, security and scanning equipment, and passenger amenities, besides waiting areas, restaurants, restrooms, duty-free shops, banks and other financial services. The ICP can handle about 600 trucks at a time. As a consequence of this enhanced infrastructural capability, trade, earlier conducted only between 8 a.m. and 4 p.m. can now stretch to 12 hours — between 7 a.m. and 7 p.m. Thus more trucks can drive to India and cross over to Pakistan every day. However, the physical infrastructure facilities at the Wagah border-control facilities must be expanded. Specifically, sophisticated X-ray machines through which trucks can pass quickly should be a top priority, warehousing is needed at Attari, and several new train stations need to be built.

⁵³ Seeking to give a big push to opening up of borders for trade and commerce, both the countries have set-up several Joint Working Groups (JWGs) such as JWG on electricity, petroleum and banking, JWG for visa, JWG for border trade at Munabao-Khokharapar route, JWG for trade in petroleum, JWG for electricity trade, etc.

of negotiations. Therefore, transit with Pakistan and Afghanistan will facilitate the market for good and energy trade (power and gas pipelines) between India and the energy rich Central Asia, South West Asia and the Gulf. The advent of MFN status may perhaps help complete the implementation of the Turkmenistan-Afghanistan-Pakistan-India (TAPI) gas pipeline, as a new environment of trust and cooperation prevails. At the same time, subregional transit between Afghanistan, India and Pakistan would help build a regional transit, thereby moving towards a Customs Union in 2015 and an Economic Union in 2020 in South Asia. Besides, India and Pakistan should work for harmonisation of trade and tariff policies, customs procedures, exchange of customs information, establishing linkages between trade associations in the trade transport and transit areas and preparation of a trade Guide and web site giving information on trade, transport, transit and customs facilitation institutions and activities.

Option 3. Allowing FDI to Narrow the Trade Gap

The GTAP simulations indicate us the winning sectors in terms of rise in export from India to Pakistan such as chemical, rubber and plastic, food processing, mineral fuels (petroleum, coal products), metals, machinery and equipment, textiles, leather products, sugar, etc. SAFTA with enhanced trade facilitation will help firms in India and Pakistan with the opportunity to exploit economies of scale through access to an enlarged market. Indian FDI (and also of other countries) would help Pakistan to narrowing the trade deficit with India. In view of bigger market size, Pakistan's MFN status to India would attract Indian FDI in Pakistan in these sectors, thereby facilitating intra-industry trade between the two countries.⁵⁴ For example, the export of petroleum products from India to Pakistan is one aspect of trade relations which will benefit from the new arrangement.⁵⁵ Undoubtedly, there would be a huge expansion in the number of new opportunities for trade and commercial enterprise in the region.

FDI becomes relevant as economic engagement between the two countries deepens. It is the intent and objective to attract and promote foreign direct investment in order to supplement domestic capital, technology and skills, for accelerated economic growth in Pakistan and India. A greater degree of bilateral investment could strengthen bilateral exports between India and Pakistan. Exports in sectors such as agriculture produce, chemicals, textiles, auto components could be enhanced through bilateral investment.

Can a Pakistani enterprise invest in India? Yes.⁵⁶ Pakistan used to be the only country from where investment was barred till 1 August 2012. Recently, Indian investors have shown willingness to invest US\$ 20 - 50 billion in Pakistan's mining, petroleum, energy, power and

⁵⁴ In a recent article, India's one of the largest business chambers commented: intra-industry trade should increase as the MFN agreement takes effect, and a large number of multinational corporations will likely set up their plants to serve both markets (Kumar, 2012).

⁵⁵ Lakshmi Mittal, an Indian steel tycoon, is currently constructing a new oil refinery in the border city of Bhatinda in India's Punjab state in association with India's Hindustan Petroleum Corporation. It will eventually have the capacity to supply large amounts of petroleum products to northern Pakistan. India's Essar Oil has entered into an agreement with Pakistan's Maple Leaf, a major cement manufacturer, to supply petcoke.

⁵⁶ But India did not allow FDI from Pakistan till recently. Indian FDI Policy used to cover: "A non-resident entity (other than a citizen of Pakistan or an entity incorporated in Pakistan) can invest in India, subject to the FDI Policy. A citizen of Bangladesh or an entity incorporated in Bangladesh can invest only under the Government route." Refer to Chapter 3, General Conditions of FDI, Consolidated FDI Policy (effective from April 12, 2012), Department of Industrial Policy and Promotion (DIPP), Government of India.

infrastructure projects.⁵⁷ Indian private sector has also shown eagerness to export electricity and petroleum products to Pakistan.⁵⁸ After enhancement in trade ties, opportunities for big projects like gas pipeline project between Turkmenistan, Afghanistan, Pakistan and India will further increase.

India has amended the Foreign Exchange Management Act (FEMA) to allow FDI from Pakistan and made an appropriate change in the Consolidated FDI Policy. Subsequently, FEMA rules were also amended, the overall FDI policy would apply to Pakistan also and proposals for investment in India by companies from Pakistan would be routed through the Foreign Investment Promotion Board (FIPB).

Pakistan had lifted restrictions on investment but no Indian was able to invest in the country. India is a large market and Pakistanis have great opportunities to set up manufacturing base, besides exporting their products. Therefore, there is an urgent need for both the governments to set up an institutional mechanism that would guarantee protection to each other's investments. At present, Pakistan and India do not have Bilateral Investment Protection Agreement (BIPA) between them. Both the countries must sign BIPA at the earliest. This would enable financial institutions to protect the investment by extending insurance coverage at market rate.

There should be a proactive policy for promoting investment through joint ventures in both countries, market access for banks in each other's market, etc. There are ample scopes for joint ventures across borders. Linking of capital and financial markets of both countries would give a boost to economic activities. An integrated network of Multi-commodity markets in SAARC countries would help in yielding maximum benefit of the region's potential.⁵⁹ Karachi Stock Exchange (KSE) and Bombay Stock Exchange (BSE) are about to sign a memorandum of understanding, which would enable KSE to be listed at BSE.⁶⁰

Improving border trade infrastructure and mutual recognition agreements to facilitate movement of goods and services is also important. Facilitating visa for increased business travel is needed. Business travelers, medical tourists and students of both the countries should be exempted from any sort of visa restrictions. On arrival visa in selected airports and land ports may be extended to the patients, investors and selected services professionals. Frequency of transport services i.e. bus, rail, air, provide limited flexibility to businessmen and common people. These steps are perceived as fruitful ways and means to boost business sentiments and bilateral relation. Finally, besides withdrawal of ban on investment in both countries, a change in the mindset on both sides of border is key to bridging the trust deficit and building an ever lasting partnership.

⁵⁷ According to Pak-India Business Council (PIBC) Chairman Noor Muhammad Kasuri

⁵⁸ There is a proposal to export surplus diesel from Bhatinda refinery in India to Pakistan through a 200-km pipeline.

⁵⁹ Refer to Mr. Joseph Massey, Managing Director of Multi Commodity Exchange, Mumbai.

⁶⁰ Refer to Mr. Muneer Kamal, Chairman, Karachi Stock Exchange (KSE), Karachi

Box 3. List of Priority Projects

1. Removal of Pakistan's negative list by 2013.
2. Removal of NTBs on fast track basis.
3. Further lowering tariffs on items in India's sensitive lists under SAFTA for non-LDCs.
4. Ease financial constraints by allowing national banks to be set up branches on either side.
5. Improve frequency of transport services in air, rail, bus and shipping. Islamabad and Delhi shall be directly connected by air. There should be more trade via rail routes and more direct shipping services between India and Pakistan.
6. Easing visa restrictions for movement of people across the border. On-arrival visa may be considered for business travelers, health patients, and selected services professionals at selected land and air ports.
7. Allow transit trade between Afghanistan, India and Pakistan. India may extend transit facility to Pakistan for its trade with Nepal and Bangladesh, and Pakistan may extend similar gesture to India for its trade with Afghanistan and West Asia.
8. India and Pakistan shall sign BIT and allow financial institutions to extend insurance coverage to business establishments in either market.
9. India is an important source of investment. Consider setting-up an exclusive economic zone or special economic zone / free trade zone in Pakistan for Indian investments.
10. Pakistan and India shall remove the positive list of overland trade at Attari-Wagah.
11. Accept a common to trade classification of products between customs authorities of India and Pakistan.
12. Set-up an institutional framework to support bilateral FDI. An appropriate redressal mechanism for trade and investment grievances shall be created.
13. Strengthen the cargo handling facilities at Attari-Wagah border, eliminate time and cost of bilateral trade by cutting excessive trade procedures and processes.
14. Open additional border crossings for increased traffic between the two countries.
15. Energy trade between the two countries shall be facilitated. Amritsar – Lahore electricity grid shall be implemented on priority.
16. Improve the road and rail networks connecting Attari and Wagah with national networks. For example, widening of NH 1 (Panipat – Attari section) to six lanes is needed to accommodate larger volume of cargo movement between the two countries.
17. Allow mobile roaming (and other value added services) to operate between the two countries.

7. Concluding Remarks

Trade is a key component of international cooperation and sustainable development. While the world has changed in fundamental ways since global financial crisis erupted in 2008, and faces challenges both old and new, furthering South-South cooperation remains vital. Merchandise exports from developed economies turned ominously downward. On the other, trade flows of developing economies have mostly remained strong. Thus, for the moment it appears that the trade slowdown is mostly confined to developed economies, especially in Europe. This suggests that South-South trade may be one of the best ways to avoid a more serious trade slump. Countries in South will continue to have higher trade with South-South region. India and Pakistan from South Asia, China from East Asia, for example, have added responsibilities to drive this momentum.

India and Pakistan have come a long way to rebuild their economic and political relations. A liberalised India-Pakistan trade regime would strengthen the economic relationship and regional integration. We need to undertake projects on priority basis not only for rebuilding the bilateral relations starting with MFN but also for strengthening South Asian regional cooperation. A list of such projects is given in Box 3. Finally, a stronger India-Pakistan relation would help realise a prosperous and peaceful South Asia.

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Appendix 1
Sectoral Composition of Pakistan's Negative List

Sectors	No. of Items
Automobile	385
Iron and Steel	137
Paper and Board	92
Plastic	83
Textile	74
Electric Appliances and Machinery	57
Pharmaceuticals	49
Machinery	37
Chemicals	33
Sports Goods	32
Ceramics	28
Cutlery	22
Glass	22
Miscellaneous Manufacturing	22
Leather goods	19
Rubber goods	19
Agriculture	16
Furniture	16
Aluminum products	12
Surgical goods	10
Footwear	7
Soap and Toiletry	7
Meters	6
Metal Products	5
Prefab Building	5
Stone and Marble	5
Wood	4
Gems and Jewelry	3
Optical Fibre	2
Total	1209

Source: Circular No. SAARC-2/4-A/2012 dated 20 March 2012, Ministry of Foreign Affairs, Islamabad

Appendix 2
Trade Complementarity Index at HS 6 Level (at H2)

HS classification	Reporter	Partner	2005	2010
HS 6 (at H2)	Pakistan	India	37.987	
HS 6 (at H2)	Pakistan	India		40.356
HS 6 (at H2)	India	Pakistan	27.289	
HS 6 (at H2)	India	Pakistan		33.419
HS 6 (at H3)	Pakistan	India		39.377
HS 6 (at H3)	India	Pakistan		33.289

Source: Calculated based on UNCOMTRADE

Appendix 3

(a) India: Intra-Industry Trade Index at 6-Digit HS (at H2), Top 20 Products

Year: 2005			Year: 2010		
HS Code	Product Description	IIT	HS Code	Product Description	IIT
841182	Of a power exceeding 5,000 kW	1.000	420292	With outer surface of plastic sheet	1.000
580134	Warp pile fabrics, ipingli (uncut)	0.999	530921	Unbleached or bleached	0.999
293379	Other lactams	0.998	730290	Other	0.999
611790	Parts	0.998	382430	Nonagglomerated metal carbides mixe	0.998
292090	Other	0.998	290243	pXylene	0.997
750522	Of nickel alloys	0.997	860210	Dieselectric locomotives	0.997
281511	Solid	0.997	230910	Dog or cat food, put up for retail	0.997
283340	Peroxosulphates (persulphates)	0.997	350190	Other	0.997
843820	Machinery for the manufacture of	0.997	551623	Of yarns of different colours	0.996
310100	Animal or vegetable fertilisers, wh	0.997	740321	Copperzinc base alloys (brass)	0.996
292222	Anisidines, dianisidines, phenetidi	0.996	80240	Chestnuts (Castanea spp.)	0.995
482340	Rolls, sheets and dials, printed fo	0.996	841012	Of a power exceeding 1,000 kW but	0.995
350691	Adhesives based on polymers of head	0.996	911220	Cases	0.994
960839	Other	0.996	790700	Other articles of zinc	0.994
790600	Zinc tubes, pipes and tube or pipe	0.996	440420	Nonconiferous	0.994
391729	Of other plastics	0.996	741011	Of refined copper	0.993
960850	Sets of articles from two or more	0.996	847920	Machinery for the extraction or pre	0.993
410411	Full grains, unsplit; grain splits	0.996	760429	Other	0.993
330210	Of a kind used in the food or drink	0.996	840212	Watertube boilers with a steam prod	0.993
480451	Unbleached	0.996	190220	Stuffed pasta, whether or not cooke	0.993

(b) Pakistan: Intra-Industry Trade Index at 6-Digit HS (at H2), Top 20 Products

Year: 2005			Year: 2010		
HS Code	Product Description	IIT	HS Code	Product Description	IIT
570241	Of wool or fine animal hair	0.999	940592	Of plastics	0.999
482290	Other	0.998	321310	Colours in sets	0.998
960920	Pencil leads, black or coloured	0.996	820840	For agricultural, horticultural or	0.997
621710	Accessories	0.995	851621	Storage heating radiators	0.995
271500	Bituminous mixtures based on natural	0.991	282810	Commercial calcium hypochlorite	0.991
960200	Worked vegetable or mineral carving	0.991	550120	Of polyesters	0.991
420299	Other	0.99	401390	Other	0.989
430390	Other	0.989	190590	Other	0.988
680430	Hand sharpening or polishing stones	0.988	570232	Of manmade textile materials	0.987
330520	Preparations for permanent waving	0.987	960400	Hand sieves and hand riddles.	0.987
821220	Safety razor blades, including razo	0.985	720450	Remelting scrap ingots	0.987
190590	Other	0.985	731300	Barbed wire of iron or steel; twist	0.986
910990	Other	0.984	843340	Straw or fodder balers, including p	0.982
91030	Turmeric (curcuma)	0.982	291732	Diocetyl orthophthalates	0.981
391590	Of other plastics	0.979	330790	Other	0.979
284290	Other	0.978	741300	Stranded wire, cables, plaited band	0.978
690990	Other	0.971	730590	Other	0.976
420212	With outer surface of plastics or	0.97	80620	Dried	0.975
732490	Other, including parts	0.97	731021	Cans which are to be closed by sold	0.975
300670	Gel preparations designed to be use	0.97	70310	Onions and shallots	0.974

(c) India: Intra-Industry Trade Index in 2010 at 6-Digit HS (at H3), Top 20 Products

HS Code	Product description	IIT
420292	Trunks, suit-cases, vanity-cases, executive-cases, brief-cases, school satchels, spectacle cases, binocular cases, camera cases, musical instrument cases, gun cases, holsters & similar containers; travelling-bags, insulated food/beverages bags,	1.000
530921	Woven fabrics of flax, containing < 85% by weight of flax, unbleached/bleached	0.999
730290	Railway/tramway track construction material of iron/steel, the following : check-rails & rack rails, sleepers (cross-ties), chairs, chair wedges, rail clips, bedplates, ties & other material specialized for jointing/fixing rails.	0.999
382430	Non-agglomerated metal carbides mixed together/with metallic binders	0.998
290243	p-Xylene	0.997
860210	Diesel-electric locomotives	0.997
230910	Dog/cat food, put up for RS	0.997
350190	Caseinates & other casein derivatives; casein glues	0.997
551623	Woven fabrics of artificial staple fibres containing <85% by weight of artificial staple fibres, mixed mainly/solely with man-made filaments, of yarns of different colours	0.996
740321	Copper-zinc base alloys (brass), unwrought	0.996
80240	Chestnuts (Castanea spp.)	0.995
841012	Hydraulic turbines & water wheels, of a power >1000kW but not >10000kW	0.995
911220	Clock cases & cases of a similar type for other goods of Ch.91	0.994
790700	Other articles of zinc.	0.994
440420	Hoopwood; split poles; piles, pickets & stakes of wood, pointed but not sawn lengthwise; wooden sticks, roughly trimmed but not turned, bent/othw. worked, suitable for the manufacture of walking-sticks, umbrellas, tool handles/the like; chipwood	0.994
741011	Copper foil, whether/not printed, not backed with paper/paperboard/plastics/similar backing materials, of refined copper, of a thickness not >0.15mm	0.993
847920	Machinery for the extraction/preparation of animal/fixe vegetable fats/oils having individual functions, n.e.s. in Ch.84	0.993
760429	Bars, rods & profiles (excl. hollow profiles) of aluminium alloys	0.993
840212	Watertube boilers with a steam production not >45 t per hour (excl. central heating hot water boilers capable also of producing low pressure steam)	0.993
190220	Stuffed pasta, whether/not cooked/othw. prepared	0.993

(d) Pakistan: Intra-Industry Trade Index in 2010, Top 20 Products

HS Code	Product description	IIT
940592	Parts of the lamps & lighting fittings of 94.05, of plastics	0.999
321310	Artists'/students'/signboard painters' colours in sets	0.998
820840	Knives & cutting blades, for machines/mechanical appliances, for agricultural/horticultural/forestry machines	0.997
851621	Electric storage heating radiators	0.995
282810	Commercial calcium hypochlorite & other calcium hypochlorites	0.991
550120	Synthetic filament tow, of polyesters	0.991
890400	Tugs & pusher craft	0.990
930390	Other firearms & similar devices which operate by the firing of an explosive charge (eg. Very pistols & other devices designed to project only signal flares, pistols & revolvers for firing blank ammunition, captive-bolt humane killers, line-thr	0.990
401390	Inner tubes, of rubber (excl. of 4013.10 & 4013.20)	0.989
190590	Bread, pastry, cakes, biscuits & other bakers' wares, whether/not containing cocoa; communion wafers, empty cachets of a kind suitable for pharmaceutical use, sealing wafers, rice paper & similar products (excl. of 1905.10 - 1905.40)	0.988

570232	Carpets & other textile floor coverings, woven, of pile construction, not made up, of man-made textile materials	0.987
960400	Hand sieves & hand riddles	0.987
720450	Remelting ferrous scrap ingots	0.987
843340	Straw/fodder balers, incl. pick-up balers	0.982
291732	Dioctyl orthophthalates	0.981
330790	Depilatories & other perfumery, cosmetic/toilet preparations, n.e.s.	0.979
741300	Stranded wire, cables, plaited bands & the like, of copper, not electrically insulated	0.978
940171	Seats (excl. of 9401.10-9401.50 & 94.02), with metal frames, upholstered	0.976
730590	Tubes & pipes (e.g., welded/riveted/similarly closed), having circular cross-sections, the external diameter of which exceeds 406.4mm, of iron/steel (excl. of 7305.11-7305.39)	0.976
80620	Grapes, dried	0.975

(e) IIT scores (IIT>0.50) of commonly traded products between India and Pakistan, 2005*

Product code	Product description	IIT 2005
490199	Other	0.993
520511	Measuring 714.29 decitex or more (not exceeding 14 metric number)	0.975
170199	Other	0.934
410719	Other	0.926
391390	Other	0.918
520542	Measuring per single yarn less than 714.29 decitex but not less than 232.56 decitex (exceeding 14 metric number but not exceeding 43 metric number per single yarn)	0.915
392010	Of polymers of ethylene	0.895
711719	Other	0.875
520942	Denim	0.852
490210	Appearing at least four times a week	0.840
80290	Other	0.805
200190	Other	0.764
410711	Full grains, unsplit	0.754
520812	Plain weave, weighing more than 100 g/m ²	0.753
903300	Parts and accessories (not specified or included elsewhere in this Chapter) for machines, appliances, instruments or apparatus of Chapter 90.	0.748
680221	Marble, travertine and alabaster	0.747
410530	In the dry state (crust)	0.746
631090	Other	0.741
520821	Plain weave, weighing not more than 100 g/m ²	0.677
291736	Terephthalic acid and its salts	0.650
640359	-- Other	0.643
611710	Shawls, scarves, mufflers, mantillas, veils and the like	0.632
844790	Other	0.632
81340	Other fruit	0.631
540710	Woven fabrics obtained from high tenacity yarn of nylon or other polyamides or of polyesters	0.599
71390	Other	0.589
392329	Of other plastics	0.557
902110	Orthopaedic or fracture appliances	0.557
580710	Woven	0.538

950662	Inflatable	0.534
701120	For cathoderay tubes	0.527
551321	Of polyester staple fibres, plain weave	0.497

*Calculated based on HS nomenclature H2

(f) IIT scores (IIT>0.50) of commonly traded products between India and Pakistan, 2010*

Product code	Product description	IIT 2010
210690	Food preparations, n.e.s.	1.00
400249	Chloroprene (chlorobutadiene) rubber (CR), other than latex, in primary forms/in plates/sheets/strip	0.99
902290	X-ray generators (excl. tubes), high tension generators, control panels & desks, screens, examination/treatment tables, chairs&the like	0.99
80520	Mandarins, incl. tangerines & satsumas; clementines, wilkings & similar citrus hybrids, fresh/dried	0.99
731816	Nuts of iron/steel	0.93
81340	Dried fruit (excl. of 08.01-08.06 & 0813.10-0813.30)	0.93
71310	Peas (Pisum sativum), dried, shelled, whether/not skinned/split	0.92
610510	Men's/boys' shirts, knitted/crocheted, of cotton	0.92
560750	Twine, cordage, ropes & cables of synthetic fibres other than polyethylene/polypropylene, whether/not plaited/braided & whether/not impregnated/coated/covered/sheathed with rubber/plastics	0.92
520511	Cotton yarn, single (excl. sewing thread), of uncombed fibres, containing 85%/more by weight of cotton, measuring 714.29dtx./more (not >14 metric number), not put up for retail sale	0.90
581092	Embroidery in the piece (excl. embroidery without visible ground), in strips/motifs, of man-made fibres	0.89
540781	Woven fabrics (excl. of 5407.10-5407.30), containing <85% by weight of synthetic filaments, mixed mainly/solely with cotton, unbleached/bleached	0.89
870810	Bumpers & parts thereof of the motor vehicles of 87.01-87.05	0.88
820320	Pliers (incl. cutting pliers), pincers, tweezers & similar tools	0.87
621790	Parts of garments/clothing accessories (excl. knitted/crocheted; excl. of 62.12)	0.87
253090	Mineral substance, n.e.s. in Ch.25	0.87
920590	Other wind musical instruments (eg. clarinets, trumpets, bagpipes), other than Brass-wind instruments.	0.86
392329	Sacks & bags (incl. cones), of plastics other than polymers of ethylene	0.86
611710	Shawls, scarves, mufflers, mantillas, veils & the like, knitted/crocheted	0.84
220720	Ethyl alcohol & other spirits, denatured, of any strength	0.83
841480	Air pumps, air/other gas compressors & fans (excl. of 8414.10-8414.59); ventilating/recycling hoods incorporating a fan, whether/not fitted with filters (excl. of 8414.60)	0.82
440420	Hoopwood; split poles; piles, pickets & stakes of wood, pointed but not sawn lengthwise; wooden sticks, roughly trimmed but not turned, bent/othw. worked, suitable for the manufacture of walking-sticks, umbrellas, tool handles/the like; chipwoo	0.81
391810	Floor coverings of polymers of vinyl chloride, whether/not self-adhesive, in rolls/in the form of tiles; wall/ceiling coverings of plastics as defined in Note 9 to Ch.39	0.81
401012	Conveyor belts/belting, reinforced only with textile materials, of vulcanised rubber	0.80
847190	Magnetic/optical readers, machines for transcribing data onto data media in coded form & machines for processing such data, n.e.s.	0.79
847141	Other automatic data processing machines : Comprising in the same housing at least a central processing unit & an input & output unit, whether/not combined	0.78
620520	Men's/boys' shirts (excl. knitted/crocheted), of cotton	0.77
640391	Other footwear without outer soles of leather, covering the ankle.	0.76

700910	Rear-view mirrors for vehicles	0.76
851230	Sound signalling equip. of a kind used for cycles/motor vehicles	0.76
251990	Fused magnesia; dead-burned (sintered) magnesia, whether/not containing small quantities of other oxides added before sintering; other magnesium oxide, whether/not pure	0.75
852872	Other colour reception apparatus for television, whether/not incorporating radio-broadcast receivers/sound/video recording/reproducing apparatus,	0.74
520831	Woven fabrics of cotton, containing 85%/more by weight of cotton, dyed, plain weave, weighing not >100g/m ²	0.73
120740	Sesamum seeds, whether/not broken	0.72
420229	Handbags, whether/not with shoulder strap, incl. those without handle, n.e.s. in 42.02	0.72
854449	Other electric conductors, for a voltage not > 1,000 V, not fitted with connectors	0.72
847490	Parts of the machinery of 84.74	0.70
411310	Leather further prepared after tanning/crusting, incl. parchment-dressed leather, of goats/kids, without wool/hair on, whether/not split, other than leather of 41.14	0.69
630900	Worn clothing & other worn articles	0.69
848190	Parts of the appliances of 84.81	0.66
500720	Woven fabrics containing 85%/more by weight of silk/silk waste other than noil silk	0.65
282710	Ammonium chloride	0.63
390110	Polyethylene having a sp.gr. of <0.94, in primary forms	0.63
420321	Gloves, mittens & mitts, of leather/composition leather, specially designed for use in sports	0.62
540784	Woven fabrics (excl. of 5407.10-5407.30), containing <85% by weight of synthetic filaments, mixed mainly/solely with cotton, printed	0.62
732690	Articles of iron/steel, n.e.s.	0.61
842240	Packing/wrapping machinery, incl. heat-shrink wrapping machinery (excl. of 8422.30)	0.61
830241	Mountings, fittings & similar articles suit. for buildings, of base metal (excl. of 8302.10 & 8310.20)	0.61
903300	Parts & accessories n.e.s. in Ch.90. for machines/appliances/instr./apparatus of Ch.90	0.59
844790	Knitting machines (excl. of 8447.11-8447.20) & machines for making gimped yarn/tulle/lace/embroidery/trimmings/braid/net & machines for tufting	0.59
520842	Woven fabrics of cotton, containing 85%/more by weight of cotton, of yarns of different colours, plain weave, weighing >100g/m ²	0.58
950699	Articles & equip. for sports, n.e.s. in Ch.95 (excl. gloves, strings for rackets, bags, clothing, footwear & nets); swimming pools & paddling pools	0.57
950659	Badminton/similar rackets, whether/not strung	0.57
640411	Sports footwear; tennis shoes, basketball shoes, gym shoes, training shoes & the like, with outer soles of rubber/plastics & uppers of textile materials	0.56
251512	Marble & travertine, merely cut, by sawing/othw., into blocks/slabs of a rectangular (incl. square) shape	0.56
130190	Lac; Natural gums (excl. of 1301.20), resins, gum-resins & oleoresins (e.g., balsams)	0.55
520911	Woven fabrics of cotton, containing 85%/more by weight of cotton, unbleached, plain weave, weighing >200g/m ²	0.55
847160	Input/output units, whether/not containing storage units in the same housing	0.53
91091	Mixtures of 2/more products of different headings of 09.04-09.10	0.53
841391	Parts of the pumps of 8413.11-8413.81	0.53
520942	Woven fabrics of cotton, containing 85%/more by weight of cotton, denim, weighing >200g/m ²	0.52
481910	Cartons, boxes & cases, of corrugated paper/paperboard	0.51

*Calculated based on HS nomenclature H3

Appendix 4

The GTAP Model

The global computable general equilibrium (CGE) modelling framework of the Global Trade Analysis Project (GTAP) (Hertel, 1997), is the best possible way for the *ex ante* analysis of the economic and trade consequences of multilateral or bilateral trade agreements. The GTAP model is a comparative static model, and is based on neoclassical theories.⁶¹ The GTAP model is a linearised model, and it uses a common global database for the CGE analysis. The model assumes perfect competition in all markets, constant returns to scale in all production and trade activities, and profit and utility maximising behaviour of firms and households respectively. The model is solved using the software GEMPACK (Harrison and Pearson, 1996).

In the GTAP model each region has a single representative household, termed as the regional household. The income of the regional household is generated through factor payments and tax revenues (including export and import taxes) net of subsidies. The regional household allocates expenditure over private household expenditure, government expenditure and savings according to a Cobb Douglas per capita utility function.⁶² Thus each component of final demand maintains a constant share of total regional income.

The private household buys commodity bundles to maximise utility subject to its expenditure constraint. The constrained optimising behaviour of the private household is represented in the GTAP model by a Constant Difference of Elasticity (CDE) expenditure function. The private household spends its income on consumption of both domestic and imported commodities and pays taxes. The consumption bundles are Constant Elasticity of Substitution (CES) aggregates of domestic and imported goods, where the imported goods are also CES aggregates of imports from different regions. Taxes paid by the private household cover commodity taxes for domestically produced and imported goods and the income tax net of subsidies.

The government also spends its income on domestic and imported commodities and also pays taxes. For the government, taxes consist of commodity taxes for domestically produced and imported commodities. Like the private household, government consumption is a CES composition of domestically produced goods and imports.

The GTAP model considers the demand for investment in a particular region as savings driven. In the multi country setting the model is closed by assuming that regional savings are homogenous and contribute to a global pool of savings (global savings). This is then allocated among regions for investment in response to the changes in the expected rates of return in different regions. If all other markets in the multi regional model are in equilibrium, if all firms earn zero profits, and if all households are on their budget constraint, such a treatment of savings and investment will lead to a situation where global investment must equal global savings, and Walras' Law will be satisfied.

In the GTAP model, producers receive payments for selling consumption goods and intermediate inputs both in the domestic market and to the rest of the world. Under the zero

⁶¹ Full documentation of the GTAP model and the database can be found in Hertel (1997) and also in Dimaranan and McDougall (2002).

⁶² Savings enter in the static utility function as a proxy for future consumption.

profit assumption employed in the model, these revenues must be precisely exhausted by spending on domestic intermediate inputs, imported intermediate inputs, factor income and taxes paid to regional household (taxes on both domestic and imported intermediate inputs and production taxes net of subsidies).

The GTAP model considers a nested production technology with the assumption that every industry produces a single output, and constant returns to scale prevail in all markets. Industries have a Leontief production technology to produce their outputs. Industries maximise profits by choosing two broad categories of inputs namely, a composite of factors (value added) and a composite of intermediate inputs. The factor composite is a CES function of labour, capital, land and natural resources. The intermediate composite is a Leontief function of material inputs, which are in turn a CES composition of domestically produced goods and imports. Imports are sourced from all regions.

The GTAP model employs the Armington assumption which provides the possibility to distinguish imports by their origin and explains intra-industry trade of similar products. Following the Armington approach import shares of different regions depend on relative prices and the substitution elasticity between domestically and imported commodities.

This study uses the version 8 database of the GTAP global general equilibrium model. The version 8 of the GTAP database has 2007 as the base year and it covers 57 commodities, 129 regions/countries, and 5 factors of production. The current study has kept the 57-commodity classification but has aggregated 129 regions into 10 as shown in Tables A3 and A4 respectively.

Table A4. GTAP Commodity Classification in the Present Study

#	Sector Name	#	Sector Name
1	Paddy rice	30	Wood products
2	Wheat	31	Paper products, publishing
3	Cereal grains nec	32	Petroleum, coal products
4	Vegetables, fruit, nuts	33	Chemical, rubber, plastic prods
5	Oil seeds	34	Mineral products nec
6	Sugar cane, sugar beet	35	Ferrous metals
7	Plant-based fibers	36	Metals nec
8	Crops nec	37	Metal products
9	Cattle, sheep, goats, horses	38	Motor vehicles and parts
10	Animal products nec	39	Transport equipment nec
11	Raw milk	40	Electronic equipment
12	Wool, silk-worm cocoons	41	Machinery and equipment nec
13	Forestry	42	Manufactures nec
14	Fishing	43	Electricity
15	Coal	44	Gas manufacture, distribution
16	Oil	45	Water
17	Gas	46	Construction
18	Minerals nec	47	Trade
19	Meat: cattle, sheep, goats, horse	48	Transport nec
20	Meat products nec	49	Sea transport
21	Vegetable oils and fats	50	Air transport
22	Dairy products	51	Communication
23	Processed rice	52	Financial services nec
24	Sugar	53	Insurance
25	Food products nec	54	Business services nec
26	Beverages and tobacco products	55	Recreation and other services
27	Textiles	56	PubAdmin/Defence/Health/Education

#	Sector Name	#	Sector Name
28	Wearing apparel	57	Dwellings
29	Leather products		

Source: GTAP Database Version 8

Table A5: GTAP Region Aggregation in the Present Study

Aggregated regions	Comprising regions
Bangladesh	Bangladesh
India	India
Nepal	Nepal
Pakistan	Pakistan
Sri Lanka	Sri Lanka
Rest of South Asia	Comprising Afghanistan, Bhutan and Maldives
China	China
USA	USA
EU25	European Union
ROW	Rest of the World

Source: GTAP Database Version 8

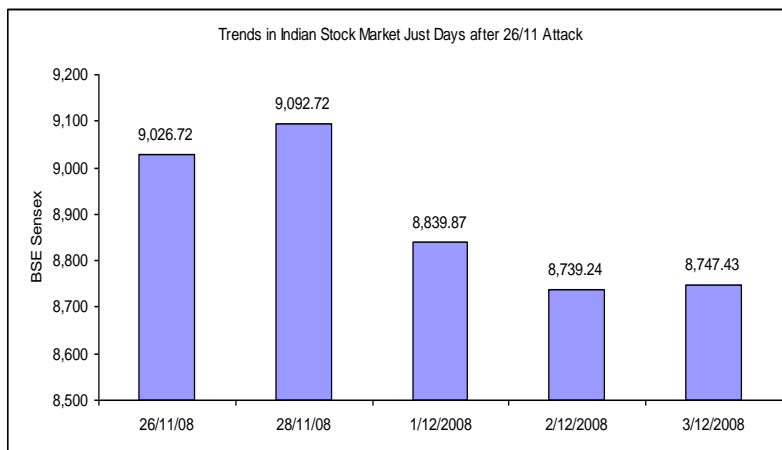
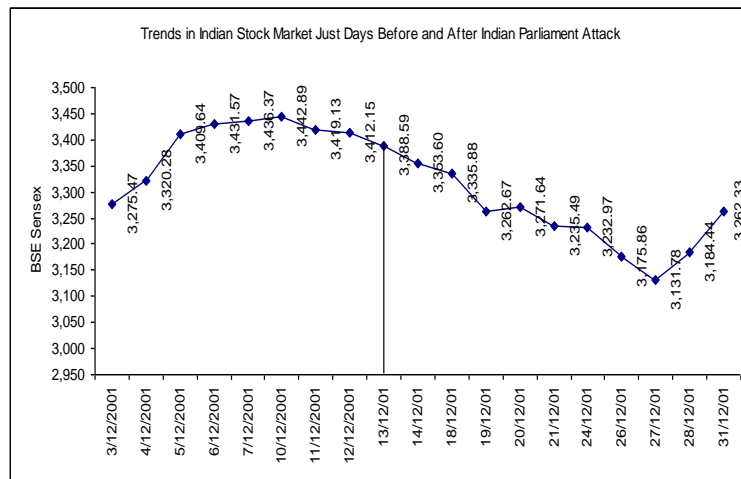
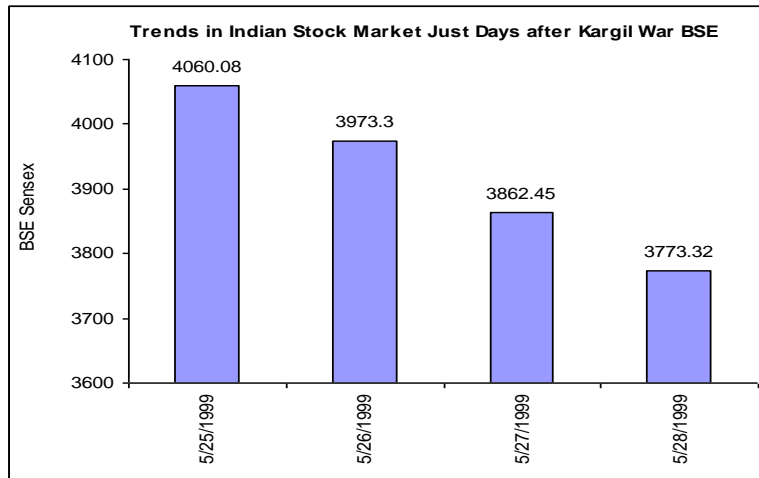
Appendix 5
FDI Inflows by Economic Groups in Pakistan in FY 2011 (US\$ million)

Economic Groups	FDI Volume
Total	1,292.9
Oil & Gas Explorations	412.30
Financial Business	223.10
Others	146.80
Power	133.80
Thermal	129.00
Transport	95.80
Telecommunications	72.90
Construction	52.80
Trade	44.80
Chemicals	34.30
Food	28.80
Personal Services	25.00
Textiles	20.10
Cement	20.10
Mining & Quarrying	12.60
Software Development	12.50
Ceramics	10.30
Tobacco & Cigarettes	9.60
Sugar	9.50
Industrial	9.10
Beverages	8.40
Buses, Trucks, Vans & Trail	8.30
Basic Metals	7.50
Transport Equipment	7.40
Leather & Leather Products	5.80
Electronics	5.00
Electrical Machinery	4.30
Hydel	4.30
Rubber & Rubber Products	3.10
Pharmaceuticals & OTC	2.40
Food Packaging	1.90
Hardware Development	1.90
Cosmetics	1.40
Metal Products	1.20
Machinery other than Electrical	0.80
Social Services	0.70
Paper & Pulp	0.50
Coal	0.50
Fertilizers	0.30
Storage Facilities	0.10

Source: State Bank of Pakistan

Appendix 6

Trends in BSE SENSEX



Source: Calculated based on Bombay Stock Exchange Data

Appendix 7
Sensitive List of India under SAFTA for Non-LDCs

HS 2	Commodity groups	Frequency	HS 2	Commodity groups	Frequency
2	Meat and edible meat offal	8	40	Rubber and articles thereof	27
3	Fish and crustaceans, molluscs and	8	46	Manufactures of straw, of esparto o	5
4	Dairy produce; birds' eggs; natural	9	48	Paper and paperboard; articles of p	12
5	Products of animal origin, not else	1	49	Printed books, newspapers, pictures	1
7	Edible vegetables and certain roots	44	50	Silk	9
8	Edible fruit and nuts; peel of citr	31	52	Cotton	12
9	Coffee, tea, matT and spices	22	54	Man-made filaments; strip and the l	5
10	Cereals	11	55	Man-made staple fibres	21
11	Products of the milling industry; m	28	57	Carpets and other textile floor cov	14
12	Oil seeds and oleaginous fruits; mi	17	58	Special woven fabrics; tufted texti	2
13	Lac; gums, resins and other vegetab	2	59	Impregnated, coated, covered or lam	3
15	Animal or vegetable fats and oils a	29	60	Knitted or crocheted fabrics	42
16	Preparations of meat, of fish or of	2	61	Articles of apparel and clothing ac	96
17	Sugars and sugar confectionery	4	62	Articles of apparel and clothing ac	77
18	Cocoa and cocoa preparations	7	63	Other made up textile articles; set	6
19	Preparations of cereals, flour, sta	1	64	Footwear, gaiters and the like; par	14
20	Preparations of vegetables, fruit,	8	68	Articles of stone, plaster, cement,	2
22	Beverages, spirits and vinegar	16	69	Ceramic products	5
23	Residues and waste from the food in	18	70	Glass and glassware	2
24	Tobacco and manufactured tobacco	9	71	Natural or cultured pearls, preciou	1
25	Salt; sulphur; earths and stone; pl	5	72	Iron and steel	49
27	Mineral fuels, mineral oils and pro	3	73	Articles of iron or steel	3
28	Inorganic chemicals; organic or ino	1	74	Copper and articles thereof	6
30	Pharmaceutical products	5	76	Aluminum and articles thereof	1
32	Tanning or dyeing extracts; tannins	8	78	Lead and articles thereof	1
33	Essential oils and resinoids; perfu	15	84	Nuclear reactors, boilers, machiner	5
34	Soap, organic surface-active agents	2	85	Electrical machinery and equipment	21
35	Albuminoidal substances; modified s	2	87	Vehicles other than railway or tram	4
36	Explosives; pyrotechnic products; m	1	90	Optical, photographic, cinematograp	2
38	Miscellaneous chemical products	2	94	Furniture; bedding, mattresses, mat	1
39	Plastics and articles thereof	70	96	Miscellaneous manufactured articles	2

Source: Compiled based on SAARC Secretariat

Appendix 8

(a) Pakistan's Import Tariff on Major Indian Exports in 2009

Partner	Product	Product Name	Tariff, simple avg., %	Import (US\$ million)	Share* (%)
India	680223	Granite	35.00	2.089	54.67
China	680223	Granite	35.00	1.672	43.77
World	680223	Granite	35.00	3.821	
India	401161	(2002-) Of a kind used on agricultural or forestry (rubber tyres)	20.00	4.406	48.64
China	401161	(2002-) Of a kind used on agricultural or forestry (rubber tyres)	20.00	1.267	13.99
World	401161	(2002-) Of a kind used on agricultural or forestry (rubber tyres)	20.00	9.058	
India	841989	Other (machinery)	20.00	2.763	1.84
China	841989	Other (machinery)	20.00	4.585	3.05
World	841989	Other (machinery)	20.00	150.197	
India	840420	Condensers for steam or other vapour power units	20.00	1.714	100.00
China	840420	Condensers for steam or other vapour power units	20.00	0.000	0.00
World	840420	Condensers for steam or other vapour power units	20.00	1.714	
India	382460	(1996-) Sorbitol other than that of subheading 290 (chemical products)	20.00	1.586	55.99
China	382460	(1996-) Sorbitol other than that of subheading 291 (chemical products)	20.00	0.338	11.94
World	382460	(1996-) Sorbitol other than that of subheading 292 (chemical products)	20.00	2.833	
India	960720	Parts (manufactured articles)	20.00	1.385	22.40
China	960720	Parts (manufactured articles)	20.00	0.463	7.49
World	960720	Parts (manufactured articles)	20.00	6.183	
India	293949	(1996-) Other (organic chemicals)	20.00	1.247	100.00
China	293949	(1996-) Other (organic chemicals)	0.00	0.000	
World	293949	(1996-) Other (organic chemicals)	20.00	1.247	
India	960719	Other (manufactured articles)	20.00	1.065	7.39
China	960719	Other (manufactured articles)	20.00	4.880	33.89
World	960719	Other (manufactured articles)	20.00	14.400	

*Share in total import

Source: Calculated based on WITS

(b) India's Import Tariff on Major Pakistani Exports in 2009

Product	Product Name	Tariff, simple avg., %	Import, US\$ million
081350	Mixtures of nuts or dried fruits of this Chapter	30.000	0.780
091091	Mixtures referred to in Note 1 (b) to this Chapter	30.000	0.116
130190	Other (lac, natural gums, resin, etc.)	26.760	0.154
080410	Dates (edible fruits & nuts)	24.000	35.383
030613	Shrimps and prawns	23.330	0.840
090910	Seeds of anise or badian	20.000	0.308
121120	Ginseng roots	20.000	0.287
200911	Frozen	20.000	0.879
350300	Gelatin (including gelatin in rectangular (includi	15.400	0.370

Source: Calculated based on WITS

Appendix 9

(a) Time to Export (days)

Year	Afghanistan	Bangladesh	Bhutan	India	Maldives	Nepal	Pakistan	Sri Lanka
2006	66	35	38	27	21	43	31	25
2007	67	35	38	27	21	43	22	25
2008	67	28	38	18	21	43	22	21
2009	74	28	38	17	21	41	22	21
2010	74	25	38	17	21	41	22	21
2011	74	25	38	17	21	41	21	21

Source: Doing Business Database, World Bank

(b) Costs of Export (US\$ per container)

Year	Afghanistan	Bangladesh	Bhutan	India	Maldives	Nepal	Pakistan	Sri Lanka
2006	2,500	902	1,150	864	1,200	1,600	996	647
2007	2,500	902	1,150	864	1,200	1,600	515	647
2008	2,500	844	1,150	820	1,200	1,600	515	660
2009	3,000	970	1,210	945	1,348	1,764	611	715
2010	3,350	970	1,210	945	1,348	1,764	611	715
2011	3,865	985	1,352	1,055	1,550	1,960	611	715

Source: Doing Business Database, World Bank

INTERNATIONAL TRADE & REGIONAL CO-OPERATION (ITRC) SECTION AT THE COMMONWEALTH SECRETARIAT

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The ITRC Section of the Economic Affairs Division (EAD) of the Commonwealth Secretariat is entrusted with the responsibilities of undertaking policy-oriented research and analysis on trade and development issues and providing informed inputs into the related discourses involving Commonwealth members.

The work of the ITRC involves:

- promoting policy initiatives and actions that foster international trade taking into account the special circumstances of our capacity constrained developing member countries
- supporting Commonwealth developing members in their negotiation of multilateral and regional trade agreements that promote development friendly outcomes, notably their economic growth through expanded trade
- undertaking policy research and consultations to enhance the understanding of changing international trading environment and of policy options for successful adaptation
- contributing to the processes involving multilateral and bilateral trade regimes that advance the more beneficial participation of Commonwealth developing country members, particularly small states and LDCs
- helping inform, through policy advice and other forms of assistance, national and regional strategies and policies that promote regional and multilateral trade and economic cooperation

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