Regional Trade:

A Growth Driver

A PBC Position Paper by the Regional Trade Panel

2011

REGIONAL TRADEPANEL

REGIONAL TRADE PANEL MEMBERS

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The panel report has been prepared by Dr. Ijaz Nabi with assistance from Kiran Javaid, Maaz Gardezi and Mariam Tareen of the Development Policy Research Center at LUMS. It is based on a survey of perceptions and a video conference of selected panel members (March 22, 2011), a brain storming session of the full panel (April 1, 2011), and a discussion at the PBC plenary (April 1, 2011). Research material used is listed in the references section of the report.

Background

Regional trade has to be seen in the context of Pakistan's overall economic growth objectives. Pakistan needs economic growth of 7 percent or more for the next four decades. This is just 1 percentage point higher than the growth rate we have achieved in several decades in the past, and only 2 percentage points higher than our average growth rate since 1947. Sustained growth at these rates will double GDP every 10 years, will result in substantial improvement in living standards within a generation and will engender a sense of optimism in the citizens. But there is an important caveat. We have to seek a growth vent (source of growth) that is geographically balanced and thus can be sustained politically. Furthermore, the growth vent we seek requires tapping into lucrative markets outside our borders in a manner that creates several growth nodes viz., a southern and western node (Karachi, the Arabian sea coastline of Sind and Baluchistan), a central node (Multan, Lahore) and a northern node (Peshawar, Abbottabad). A liberalized economic relationship between Pakistan and India and other neighbors (Iran, Central Asia and China) can help achieve all three objectives: a high growth rate that is regionally balanced, and can therefore be sustained for a longer period than we have ever achieved in the past (I. Nabi, August 2010).

Seen in the context outlined above, the current state of trade between the two largest South Asian economies is not encouraging. Pakistan and India account for most of South Asia's regional GDP (nearly 90%, Figure 1a) and yet direct trade between the two largest regional economies is almost non-existent (Figure 1b shows that in 2009 India Pakistan world-wide trade was $462 billion and their bilateral trade a mere $1.7 billion). While a more conducive trade regime with other regional neighbors is important, the critical area of focus (as viewed by the Pakistan Business Council) is our trade and broader economic relation with India.

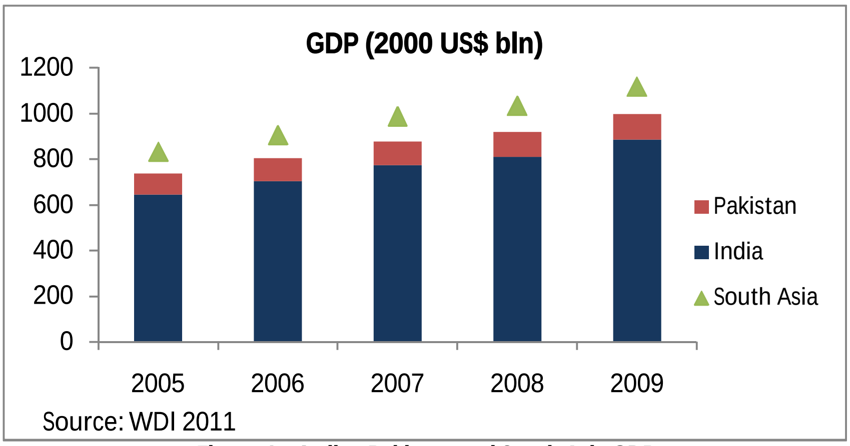


Figure 1a: India , Pakistan and South Asia GDP

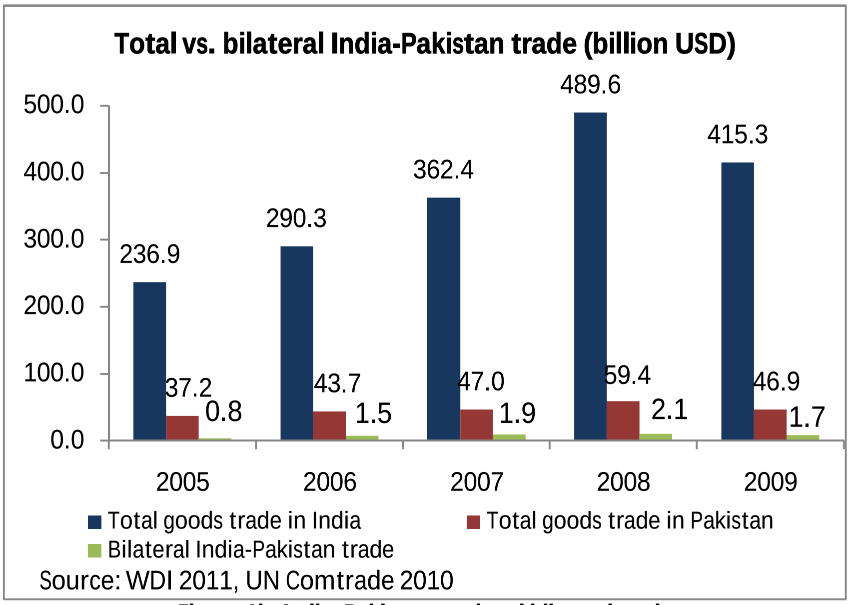


Figure 1b: India, Pakistan total and bilateral trade

India and Pakistan share a long border, have similar language, taste, and cultural ethos, and until not too long ago enjoyed well-connected markets and transport networks. These features should provide a good launching pad for trade and investment flows. However, this has not been the case. Trade relations have been difficult in the past because India and Pakistan have viewed each other through a geo-political lens and not as vibrant trading partners. This outlook has to change and Pakistan, in particular, needs to recognize that India is no longer confined to a low "Hindu rate of growth" but is a vibrant, rapidly modernizing economy that is increasingly integrated with the world economy. India's recent GDP growth rate averaging 8 percent is more than twice ours (Figure 2) and because India's population growth is lower, per capita income in India is growing even faster (Figure 3). This divergent economic performance has several implications (Table 1). One is that in the not too distant future living standards, including the quality of infrastructure and public services, will be better in India. Significantly, India will also have a larger lobbying presence in international forums, which will have consequences regarding our ability to maintain parity across a broad range of contested and competing issues. Further, India's capacity to modernize its security establishment will be far greater than ours.

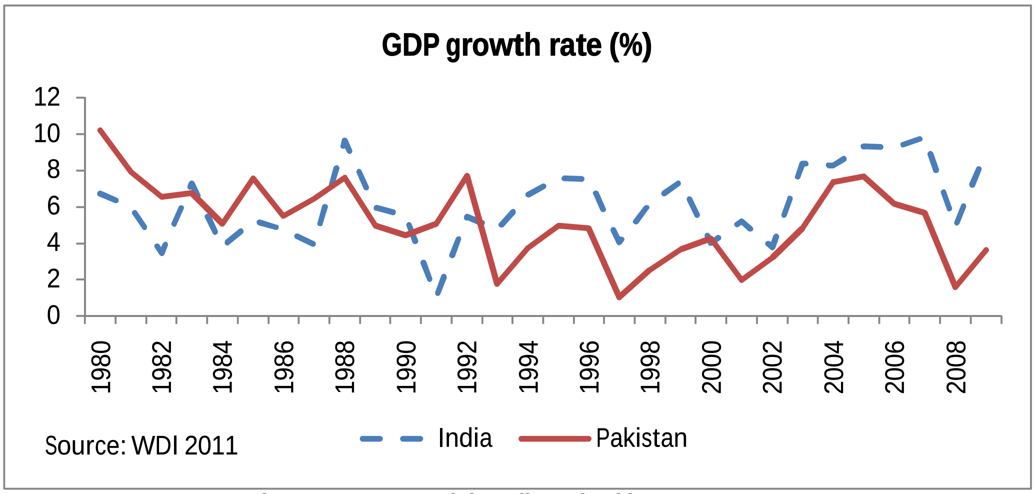
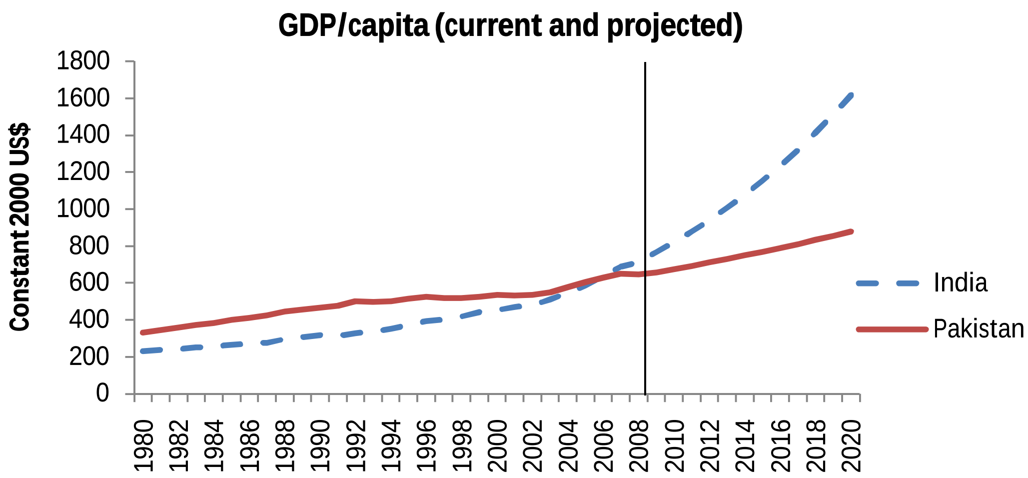


Figure 2: GDP growth in India and Pakistan 1980-2008

The key question is how we can turn India's growing economic capability to our advantage and thus bridge the income gap and then over take India's growth rate , as we did in the 1960's and the 1970's. This is not as ambitious as it might seem given the current performance of the two economies. As Figure 2 shows, in most years in the 1980's, Pakistan's GDP growth was higher than India's. Furthermore, even now, Pakistan ranks higher than India on many indicators of the cost of doing business (Table 2). Thus a solid foundation already exists to build a mutually beneficial economic relation with India.



Source: WDI 2011

Note: The projections have been done using growth rates averaging over the last 5 years.

Figure 3: Current and Projected GDP per capita in Pakistan and India (in the absence of a pick-up in Pakistan's growth).

Table 1: Sobering trends

	2006	2020
Pakistan's GDP as share of India's GDP	14 percent	9 percent
GDP per capita in Pakistan as percentage of India's.	99 percent	54 percent
$ value of one percent GDP spent on services (or defense) in India	$7 billion	$22 billion
$ value of one percent GDP spent on services (or defense) in Pakistan	$1 billion	$2 billion

Table 2: Investment and Cost of Doing Business Indicators Comparison (2010)

Indicators	Pakistan	India
Trade: Cost to export (US$ per container)	611.00	1055.00
Trade: Cost to import (US$ per container)	680.00	1025.00
Trade: Time to import (days)	18.00	20.00
Ease of doing business index (1=easiest to 183=most difficult)	83.00	134.00
Cost to start a business (% of income per capita)	10.70	56.50
Time required to start a business (days)	21.00	29.00
Procedures required to start a business (number)	10.00	12.00
Total tax rate (% of profit)	31.60	63.30
Profit tax (%)	14.30	24.00
Other taxes (%)	2.30	21.10
Tax payments (number)	47.00	56.00
Time required to enforce a contract (days)	976.00	1420.00
Cost to enforce a contract (% of claim)	23.80	39.60
Procedures required to build a warehouse (number)	12.00	37.00
Closing a business: cost (% of estate)	4.00	9.00
Closing a business: recovery rate (cents on the dollar)	36.50	16.30

Source: Doing Business 2010, World Bank

A historical perspective is useful to appreciate that a liberal economic relation with India would be a source of economic growth for Pakistan.

The regions that comprise Pakistan have enjoyed five major growth vents in the last 100 years that have contributed to improving living standards. The first growth vent, lasting nearly half a century, was the construction of canals in the Indus basin that brought about long lasting changes in the design of institutions, location of population and modes of exchange that now constitute the core structures of our economy. Subsequent growth vents were experienced following Independence in 1947. The first was the Korean War boom that has had a deep impact on how we have managed the economy (the exchange rate policy and preference for consumption over savings and investment can be traced back to this commodity boom). The second was import substituting industrialization that gave us rapid growth in the 1960’s (but growth that could not be sustained). The third was the green revolution technology that gave robust agricultural growth in the 1970’s and 1980’s and, finally, overseas migration and the resulting remittances that have spurred growth for the last 30 years.

Each of the growth vents sketched above has contributed significantly to increasing living standards but these sources of growth have now been exhausted. The economy is thus poised for a new growth vent. The consensus view of the Pakistan Business Council is that regional trade would constitute such a growth vent. However, the full benefits of this source of growth will not be realized without the resumption of trade and broader economic relations (skills, technology and investment flows) between India and Pakistan. Significantly, such a growth vent would also bring about more regionally balanced growth within Pakistan (see Box 1 below).

Box 1: Regional trade beyond the borders to promote more regionally balanced trade within the border: A historical perspective

Historically, the regions of Lahore, Peshawar and upper Sind were connectors of the lands to their west – Iran, Central Asia and China - and those to the east – India - and as such became centers of trade, commerce and culture. This flourishing activity made them growth nodes that brought prosperity to their surrounding regions.

Lahore in Punjab was the center of trade, commerce, finance and education for a region that included Indian Punjab, Haryana, Jammu and Kashmir valleys and Himachal Pradesh to its east, and linked these regions with Persia and Central Asia to its west. Lahore was cut off from the West with the coming of the British and from the East soon after 1947.

The ancient walled city of Peshawar has cast a huge and disproportionate shadow on South Asia's culture. The prominence of Peshawar is on account of the fact that the merchants of the walled city constituted a prosperous hub of economic transactions between South Asia and the Central Asian territories. The civilizing influence of trade on the surrounding Pashtun areas would also have been substantial. Imperial rivalry between Russia and Britain cut off Peshawar from its northern markets and 1947 severed access to the Indian markets. The pool of economic transactions for Peshawar shrank dramatically. It is also noteworthy that the modern silk route through Hazara and Gilgit Baltistan on to China is an attempt to reproduce the ancient trade links that were severed during colonial times.

Sind is hugely significant in shaping our religious/cultural psyche embedded in the venerated Sufi tradition of Islam. The Sufi saints chose to settle in Sind along the Indus because there were receptive host communities that were benefiting from the trade routes between markets in territories that now lie in India and Iran through Baluchistan.

These cultural centers have defined themselves historically based on a pattern of economic transactions, trade routes and cultural influences, as parts of much larger regions that lie outside the borders of the modern nation state of Pakistan. A liberalized regional trade regime, especially one between India and Pakistan, will help restore the vibrancy of all three major economic/cultural centers of Pakistan and thus would contribute significantly to the objective of regionally balanced growth.

(I. Nabi, August 2010)

The Key Issues

(i) <u>Post liberalization trade and investment volumes</u>

Predicting trade and investment volumes following economic liberalization between India and Pakistan is difficult. On the one hand, there is history and cultural similarity and, on the other, there are grievances and grudges. PBC regional trade group (that comprised businessmen, academics and civil servants) did a survey of perceptions within the group. The range of perceived trade flows following liberalization is reported in Table 3. The longer term perceived impact (in about ten years of liberalization) is significant.

However, in order for trade flows to realize their full potential, investment flows must also be on the normalization agenda. Influx of investment will be good news for Pakistan as it currently needs capital inflows to move to a higher growth trajectory. India, being right next door, and with a large pool of savings would be a promising source of investment. Three-fourths of the panelists agreed that investment flows by both Indians and Pakistanis, following trade liberalization, will increase in volume. Hence it is not only the Pakistan economy that would benefit from bilateral investment flows; India also stands to gain. As compared to their home-country, Indian investors will find in Pakistan an environment much more conducive to economic activity (see Table 2). The assumption, of course, is that law and order in Pakistan will have improved significantly.

Joint ventures of Pakistani and Indian investors can be visualized in the old trading centers of Peshawar, Lahore and Sind taking advantage of plentiful Pakistani labor, shorter transportation costs (from Peshawar to the Central Asian markets, and from centers in Karachi and Gwadar to the Gulf and Middle East markets) and Pakistan's excellent infrastructure along the North South Corridor (linking Peshawar, Lahore and Karachi).

Table 3: Pakistan Business Council (regional trade group members) perceptions on likely trade and investment flows following India-Pakistan liberalization

	Trade volume	Investment flows into Pakistan	
		By Pakistanis	By Indians
Short term	$1-5bln	Substantial increase	Sustained increase to be more than $1bn a year.
Medium term	$10-20bln		
Long term	$15-50bln		

(ii) Tapping into India's knowledge economy

Partly because of size and partly because of shrewd investment in higher technical education, India is rapidly positioning itself as a knowledge economy. This is best evidenced in the phenomenal success in the IT sector. India now accounts for 60 percent of global outsourcing in this sector (export of computer and business services in 2008 was estimated at $52.3 billion). Indian manufacturing sectors of pharmaceuticals and automotive parts are also emerging on the international scene. There is also an impressive network of agricultural research. A liberal trade and investment regime will allow Pakistan to tap into the pool of Indian skilled workers and technology to improve international competitiveness of Pakistani firms.

Box 2: Accessing Indian Technical Expertise: The Case of Pharmaceuticals
(CEO, GETZ Pharma, Mr. Khalid Mahmood)

Pharmaceuticals are the seventh largest manufacturing export of Pakistan, amounting to $100 million. Despite the remarkable development of this industry in the past couple of decades, Pakistan lags well behind the big players of the region- India and China. The growth of the Indian pharmaceutical industry, for the local market and the export market of both formulations and raw materials has been an astonishing 20-25% per annum in the last half decade and at $15 billion in 2009/10, Indian export of pharmaceuticals, drugs and fine chemicals is huge compared to Pakistan's. Furthermore, US $ 6-10 billion of research and development work, clinical trials, bio-equivalent studies have been invested by the West in India in the last decade – technologies that do not exist in Pakistan.

Aside from import of pharmaceutical raw material (considerably cheaper than other suppliers), Pakistan has much to learn from India on Pharmaceuticals technology. Indian machinery for pharmaceutical manufacturing costs less than half of other international suppliers. More importantly, senior Indian pharmaceutical technical consultants, who can design plants and systems for companies in Pakistan, will strengthen international competitiveness of Pakistani firms enabling them to export to Europe and the U.S. Recent experience of Pakistani firms with Indian consultants is that their consultancy rates are half those of the Europeans and they have a better working ethos. Importantly, for cultural reasons, they have worked congenially with companies in Karachi. Such transfer of skills from India came to an abrupt end after the Mumbai attacks. It is now time for Pakistan to normalize the relationship to build a strong foundation for future growth of this industry.

Box 3: Implications for Automotive Parts Industry
(CEO Spelgroup, Mr. Almas Hyder)

Pakistan's automotive parts industry has seen remarkable growth in the last ten years under the present trade policy and local market conditions. Liberalizing the broad economic relation with India will present new opportunities but also some challenges. The biggest opportunity, of course, will be access to the much larger Indian market for automotive parts that will allow us to overcome the problems of small scale, and thus may help us become more competitive globally. We are likely to be competitive due to currency advantage. This will help us in acquiring Indian technology and raw material in the diverse fields of plastics, rubber and metals that are needed in automotive parts. Joint ventures would facilitate such access even more. We can also look to hiring Indian industry specialists as consultants to improve our engineering and business practices. Also, many global companies now have service centers in India and a more open economic relationship will allow access to the technical know-how of such advanced global companies. Importantly, land routes through India will provide greater access to other SAARC countries where we already enjoy competitive advantage.

However, we will need to be watchful as we liberalize trade with India. Tariff/ administrative barriers in India are perceived to be rampant and would negate the benefits mentioned above. Furthermore, there is the perceived risk that India's strong technology base may create one-way trade and may harm local industry, especially the small and medium manufacturers who are just finding their feet. The process for remedying such potential harm needs to be put in place and staffed up with the best expertise in order to avoid delays in providing remedy. The protective environment currently enjoyed by the Pakistani automotive parts industry will be removed and this will lead to a major industry shake up. There will, inevitably, be losers and this needs to be thought through in calculating the benefits of opening up to India.

Box 4: Perspective of General Tyre and Rubber Company (Chairman General Ali Kuli Khan Khattak).

The tyre industry was established in Pakistan some 47 years ago with foreign investment in General Tyre. The company continues to enjoy strong technological support from a tyre manufacturing giant in Europe. Many medium sized firms have also entered the industry but without technological backing from an established source and, therefore, industry quality standards have fallen.

Market size for tyres is currently estimated at around 6.2 million tyres per year. Local manufacturing accounts for one-third and imports cater for the rest. There is massive under-invoicing of imports and smuggling is rampant. The Indian tyre industry is at least six times the size of Pakistan's. This is on account of several factors: India's larger domestic market, consistent and highly protected import policies over the years and a recent surge in international business confidence that has attracted high volumes of foreign investment and latest technology. An example is General Tyre's European technology partner that has recently acquired a fully owned subsidiary in India, taking Indian tyre technology to an even higher plane. For reasons well known, Pakistan has not been able to attract similar investors.

The main benefit in liberalizing economic relations with India would be the transfer of technology, especially from the more advanced foreign companies and joint ventures in the Indian tyre industry. This should be accompanied by an aggressive policy for quality standards in our domestic tyre industry combined with efforts to curb smuggling and under-invoicing. Another advantage, of course, is that the market in smuggled Indian tyres will be formalized and subjected to the standard policy framework. These policies, in conjunction with technology transfer from India, will put our industry on par with Indian manufacturers. The growing Indian market would then become an export destination for Pakistan's tyre industry.

Being a huge land mass, the logistic/transportation costs, depending on the location of the manufacturers, are considerable within India (made worse by the fact that India's internal logistics costs are high by international standards). This will play to Pakistan's advantage and we would emerge as a more economical option for Indian tyre markets close to our borders. But we must move quickly before India's infrastructure improves.

We would, of course, need to ensure that our potential exports are not discouraged by non-tariff barriers in India (in particular, restricted entry points); this has to be negotiated as part of the liberalization deal with India.

Box 5: The Case of Textiles
(Shaukat Ellahi Sheikh, Managing Director, Nagina Group)

Pakistan's textile industry accounts for 9% of GDP, 46% of manufacturing value added, 55 percent of export earnings and 38% of manufacturing sector employment. The comparable figures for India are 4%, 20%, 17% and 21% respectively.

Pakistan and India have created a large textile industry with the current focus being on producing goods primarily for exports. Both countries enjoy comparative advantages in the sector due to indigenous production of raw cotton and abundance of cheap labor. The textile sector was very successful in launching the industrialization of both countries. Recent data shows that India was successful in creating a textile industry with heavy focus on the finished product while Pakistan remained inclined to producing and exporting intermediate products like yarn and greige fabrics. India produces approximately 5.44 million tons of raw-cotton while Pakistan produces 1.85 million tons annually. Further, India has been successful in creating a large chemical based synthetic fiber and product industry with export capability while Pakistan could manage to produce only a portion of its synthetic fiber needs. India was also quick to establish a large machinery manufacturing base which has become a significant source of capital goods for the Indian textile industry. However, Pakistan has still to make its mark in the capital goods producing industry and relies largely on imported machinery for textile production.

The importance of the textile sector to Pakistan in terms of export earnings, employment, proportion of gross domestic product and linkages with the rural sector is enormous. It is imperative that Pakistan is able to sustain the textile sector. Under normal circumstances the ideal plan for Pakistan would have been to grow the textile industry by investing heavily in completing the value chain i.e. using the intermediate items currently being produced to manufacture finished textiles like garments, towels and home furnishings. However, the massive energy shortages being suffered by Pakistan, shortage of indigenous production of raw cotton and synthetic fibers together with a negative image due to law and order issues is preventing this investment. Therefore, Pakistan needs access to markets for its intermediate products until it too can create a sizeable finished product industry. China is one such market which is importing intermediate products from Pakistan. However, if Pakistan could get greater access to the Indian market, it could benefit from the finished goods manufacturing capability of India.

Liberalizing textile trade with India will be a significant boost to the Pakistan textile industry in other ways also, some of which are: (i) access to relatively cheap raw cotton and synthetic fiber. Due to the short distance, Pakistan will not only benefit from the cheaper price but also the ability to source raw material just in time, (ii) access to significantly cheaper Indian textiles machinery and spare parts, (iii) access to technology in India: due to the large size of the Indian textiles industry and its vertical integration, the human resource in Indian textiles industry has developed to world standards. However, Indian consultants are significantly cheaper than those from Europe and the United States.

It is important that policies create a liberalized environment that allows fair trading. Pakistan and India thus will have to create a framework where issues like tariff rationalization, anti-dumping measures, efficient payments and settlement systems, free movement of businessmen and laws governing logistics can be worked out. We will do well to remember that in a liberalized environment, Pakistan will gain access to a market of 1.1 billion people in an economy growing at 8% plus annually and creating a middle class with a huge appetite for textiles.

Box 6: The Case of Agriculture:
(Farmer, Industrialist and Member National Assembly, Mr. Jahangir Khan Tareen)

India's agricultural development still has a long way to go as does Pakistan's but there are some key areas where India has developed faster as their needs are more critical. This is also because India has been markedly more successful than Pakistan in creating the legal and institutional basis for development of the private sector in agriculture support services. Two sub sectors will benefit substantially from the opening with India:

a. Seed Industry:

Pakistan fulfills the bulk of its vegetable seed requirement by import from India. In other sectors as well e.g. Alfalfa, India is the importer of choice. This is due to two reasons: one, the lack of seed development research in Pakistan and secondly, the similarity of climate which makes seed produced for north India adaptable to Pakistan.

In the last decade Indian cotton farming has progressed by leaps and bounds primarily due to the sustained development of the private sector seed companies, which have been able to structurally link to the international technology pipeline. The best example is the number of Monsanto licensees and partners in India and the maturing of hybrid cotton production.

If Pakistan-India trade is opened up at the formal level and the private sector on both sides becomes confident of the durability of the trading relationship, Pakistan can benefit significantly from the heightened status of Indian research. It should be noted that the development of the Indian seed industry is mainly responsible for the jump in Indian cotton production of over 75% in less than a decade while Pakistani cotton production has stagnated in the same period of time.

b. Powered Irrigation:

A significant difference in Pakistani and Indian agriculture is the percentage of irrigated land in the total cultivated area of the country. In Pakistan the bulk of cultivated area is irrigated and in India it's the other way round with the bulk of the area dependent on rainfall. This has led to the increasing use of drip irrigation and power irrigation in India.

The Indian private sector has been at the forefront of this effort and is therefore much further along the learning curve than the Pakistani private sector. Given that Pakistan is increasingly becoming a water deficit country, sustainable free trade will lead to this technology transfer for the benefit of the Pakistani farmer.

(iii) Non-tariff barriers

There is widespread perception in Pakistan that the Indian trade regime includes a long list of non-tariff barriers that affect trade volumes despite a statutory liberal tariff regime. This is offered as the principal reason why India imports little from Pakistan despite having given most favored nation status to Pakistan unilaterally. The biggest non-tariff barrier in trade flows, of course, is poor trade logistics and visa restrictions that hamper businessman from travelling across the border to strike trade deals. These non-tariff barriers are the result of security based relationship between the two countries that needs to be revisited if trade is to take place on a meaningful scale.

Non-tariff barriers are also slapped on for health and safety reasons and there is evidence that the Indian trade regime includes such barriers in its protectionist arsenal. The extent to which these barriers are protectionist and harmful to regional trade needs to be investigated. We should use this opportunity also to examine our own trade regime for similar trade retarding measures.

Anti-dumping measures are another form of non-tariff barriers especially when they are invoked by monopoly producers of intermediate materials. There is evidence that the Indian trade regime uses anti-dumping measures to protect large Indian manufacturers. However, this is not a Pakistan specific measure. Furthermore, the use of anti-dumping is on the rise in Pakistan also for the same purpose, i.e. to protect monopoly/oligopoly producers of intermediate goods. As in India, such protection raises the production cost of downstream small and medium sized firms. The use of anti-dumping to protect local monopolies lowers welfare gains from trade and must be reviewed for their efficacy.

(iv) Gainers and losers from trade with India

A number of studies (Ministry of Commerce, 1996; Nabi and Nasim, 2001; Naqvi and Nabi, 2008) have carried out careful analysis of gainers and losers from liberalizing trade with India. The studies conclude:

- Pakistani consumers will be unequivocally better off as seasonal price hikes will be brought under control via access to a much larger market. Costs of most consumer products will fall and the variety available will increase. It will also help moderate inflation that affects the poor disproportionately and contributes to political instability.
- Farmers will benefit from exchanges on technical know-how, the benefits of which can be easily conveyed across our long common border. This will help boost farm productivity and lower costs of production for Pakistani manufacturers, making them more competitive internationally. Furthermore, rural incomes will rise, which will help lower rural poverty and ameliorate political tensions in the rural areas.
- Our small manufacturers will be able to enjoy potential sub-contracting arrangements with larger Indian manufacturers, which will help increase their efficiency. Our industrial clusters of small manufacturers in Sialkot, Gujranwala, Gujrat, Faisalabad and Hyderabad will be the chief beneficiaries, enjoying scale advantages of producing for a much larger South Asia-wide market.
- Some large-scale manufacturers who enjoy monopoly power in the Pakistani market and are subsidized by the government will be adversely affected in the short run. On the other hand, more dynamic producers will become more competitive which will boost Pakistan's exports in the international market. Liberalization will also allow commodities apart from textiles to enter into our trade mix, providing sectors other than textiles an opportunity to grow.
- Lastly, the government will be better off because legalized trade will generate tax revenues now lost to smuggling.

Even though the studies yielding the conclusions listed above use sound analytical techniques, they are static in nature, and cannot capture the full dynamics of trade liberalization. In the real world, trade liberalization has invariably resulted in much larger gains than any static analysis can predict.

(v) National security and stop-go India-Pakistan trade

Economic liberalization with India may help allay security concerns that have prevented trade from flourishing. Opening up of trade and two-way investment flows will create stakeholders on both sides of the border who will lobby for keeping the overall relationship between India and Pakistan on an even keel. The panel estimated that flows amounting to approximately 10-15 billion USD will prove to be the tipping point, making the gains from trade large enough for economic well-being to outweigh geo-political pre-occupations.

Box 7: The new (old) road to Kashmir

The time is ripe to take a new –and yet familiar – road to Kashmir. This road would be built on the solid foundations of economic geography and trade.

The high valley of Kashmir drains into northern Punjab via rivers and "nullahs". Clinging to the contours of the drainage system are land routes that have facilitated movement of people and goods for centuries. This has evolved into an intricate network of commercial and social "biradaries" that bonds northern Punjab and Kashmir and has facilitated the outflow of Kashmiris from the resource-poor valley into the plains. The new strategy must re-establish this network.

This can only be done through unbridled trade with India across the entire length of the international border and the Line of Control. We are committed to this in the SAARC agreements. Let us hasten it forward.

Trade with India can only do good. Consumers will benefit unambiguously. Some powerful protected manufacturers will be hurt but they have enjoyed super profits long enough. Let them now compete. Many will see India as an opportunity to enjoy scale economies that a large middle class offers. Agriculture will benefit from the more advanced crop technologies across the border.

A liberal trade regime will promote greater travel. We will see, firsthand, the historical evidence of the grandeur of Muslim rule in India and visit the *dargahs* of sufi-saints. The Sikhs will travel to Hasanabdal, Nankana and Lahore to pay homage to their history and religion. An elderly generation of Punjabi and Sindhi Hindus in India and Northern Indian Muslims in Pakistan will fleetingly re-capture the "gali- koochas" of their youth. How can this be bad?

And if commerce and people begin to move freely along the old trade routes across the LoC and re-create traditional networks, who will be able to tell where "Occupied" Kashmir ends and "Azad" Kashmir begins?

A liberalized trade regime could easily see India-Pakistan trade jump to $2-3 billion and much larger in the medium term. Powerful commercial lobbies in Delhi, Lahore, Bombay and Karachi will then ensure that no one tramples on the rights of Kashmiris to trade, fraternize and prosper — be they Muslim, Hindu or Buddhist. How could this be bad?

Ravian, DailyTimes, 13 September 2002

(vi) SAFTA, ECO, China and Pakistan

The calculus of costs and benefits of liberalizing bilateral India-Pakistan economic relationship pales in comparison to the potentially huge benefits of seeing that opening in the context of Pakistan's role, given its location as the connector of regional power houses.

Resource rich ECO (Economic Cooperation Organization comprising Central Asia, Iran and Turkey) and manpower rich SAFTA are naturally complementary regions and together they can turn this land of nearly 2 billion people into an economic power and reclaim its historical position as a cultural hub. Pakistan enjoys the unique location advantage as a connector of the two regions. As things currently stand, Pakistan is on the periphery of SAFTA and India plays the role of connecting the SAFTA economies and enjoys the benefits that accrue. The natural economic alliance of SAFTA and ECO will shift the role of the regional connector to Pakistan along with all the economic benefits that are associated with this role.

Pakistan's role as a connector of regional economies gets further fillip from the fact that our location allows us also to connect SAFTA and ECO to the other regional power house, China. Thus our geographical location, supported by a sensible geo-political strategy and complemented by investments in skills and infrastructure, and trade policies that support the facilitation of regional trade rather than protect local monopolies, will open up economic opportunities on a scale we cannot even imagine in our current economically confined state. Box 1 shows that we have historically enjoyed this role and the benefits that come from it.

Recommendations

I. Regional trade

(i) Redefining the national security paradigm:

The greatest threat to national security now comes from violent internal dissention rooted in economic depravity. Economic well-being and the promotion of regional trade that will rejuvenate economically deprived border areas should therefore be the cornerstone of the new national security paradigm.

(ii) Improving internal governance:

Improving the internal law and order situation, which includes eradication of violent militant groups as well as protection of property rights and improved overall governance, must be core elements of the new national security paradigm.

(iii) A supportive trade policy:

Given the strategic role Pakistan has to play as a connector of trade between three vibrant regions of the world, the trade policy has to be agile and forward looking. A recent review of trade policy carried out for the Planning Commission[1] shows that it lacks strategic focus and the policy making environment is in need of thorough reform. It has to move away from protecting local monopoly interests focused on our small internal market to facilitating regional trade. This will require a much more strategic trade policy and, in turn, will need more skilled personnel and better functioning institutions to design and implement the policy.

The role of the National Tariff Commission in particular, needs to be examined. It must move away from initiating anti-dumping proceedings at the behest of those who seek costly protection (and thus put road-blocks in the flow of trade) to building up the capacity to reject quickly bogus complaints of dumping.

[1] Pakistan's Trade Policies: Future Directions , prepared by Garry Pursell, Ashraf Khan and Saad Gulzar with support from the International Growth Center.

(iv) Develop a strategy for transit trade:

To enjoy the full benefits of trade and investment flows between China, Central Asia, Iran and India, a comprehensive strategy for promoting transit trade corridors must be developed, including capability to process goods.

(v) Supportive infrastructure investments

Investment will be needed to upgrade infrastructure that includes road/railway networks and move to state of the art trade facilitation (customs clearance, warehousing). Public-private partnerships (including investors from regional trading partners) should be harnesses to build the infrastructure cost-effectively.

(vi) Conducive financial services

The regulatory framework must be fine-tuned so that banking and other financial services can play their proper role of lubricating regional trade and facilitating investment flows.

II. Specific to India

(i) Timing:

Liberalizing the economic relationship with India takes on greater urgency with time to enable us to enjoy our current entry point comparative advantage in the cost of doing business, and especially the advantage in infrastructure efficiency; this advantage will be eroded as India reduces business costs and improves its infrastructure. Had we liberalized twenty years ago, we would have enjoyed the entry point advantage of a much better overall investment climate that we lost over time.

(ii) MFN status:

Give India MFN status. The immediate implication of this is to allow trade with India based on the usual negative list (prohibiting trade in explosives, goods that pose risk to the environment and health etc) rather than a positive list (only those goods on the list can be imported).

MFN status to India must be accompanied by setting up a bilateral commission to address the issues that are closely tied up with India and Pakistan having a normal economic relationship that results in sustained benefits. The commission would focus on:

a. Goods and services related non-tariff barriers:

Use the WTO framework for addressing Indian (and Pakistani) non-tariff barriers and then bring these into the strategic regional trade policy framework outlined above. Develop institutional capacity (National Tariff Commission) to address non-tariff barriers and anti-dumping complaints with a view to promoting trade rather than hindering it.

b. Land routes:

The maximum benefits from a more liberal trade regime with India will come from land routes that minimize response time to market forces; open up as many land routes as possible, building on the old road and railway networks all along the border from the Kashmir region to the Arabian Sea.

c. Travel:

Travel (visa, air/road/railway transport) must be facilitated to promote competitive trade in goods and services that benefits small and medium sized firms, to tap into the large pool of Indian skilled workers, gain access to Indian farm and other technology and encourage cross border tourism.

(iii) Cross border investment flows:

The regulatory framework must facilitate cross border investment flows rather than hinder it.

(iv) Proactively address the trust deficit to prevent stop-go cross border trade:

To create a sustained momentum for liberalizing trade and investment flows, set up a regional trade forum (comprising the private sector, academia and the media), that monitors the working of the bilateral commission mentioned above. The forum should identify barriers to trade embedded in the trade policy, the payment system and communications (including travel); the forum should also help identify losers from liberalizing trade with India and suggest ways to compensate them and should help in formulating a broader regional trade and investment promotion strategy.

Initiatives like "Aman ki Asha" have the capacity to build large constituencies for healthier India-Pakistan relationships and should be encouraged as part of the strategy to have a more orderly transition to a liberalized economic relationship with India.

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