

TRADE OF INDUSTRIAL GOODS WITH INDIA: OPPORTUNITIES AND CHALLENGES FOR PAKISTAN

POLICY RECCOMENDATIONS PAPER

TRADE RELATED TECHNICAL ASSISTANCE PROGRAMME



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EXECUTIVE SUMMARY

Report Summary

This is a brief summary of the report that assesses the probable impact of normalization of Pakistan-India trade on certain sectors of Pakistan's industry. These industries have been selected on the basis of their defensive or offensive interest or for their importance in value chains. Included in the study are i) passenger cars, ii) tractors, iii) motorcycles, iv) auto parts, v) electrical fans, vi) surgical instruments, vii) pharmaceuticals and viii) chemicals. The report also looks at the current level of trade facilitation across the Wagah-Attari border and how that can be improved.





This study concludes that expanded trade with India can bring substantial benefits for industrial sectors in Pakistan, including building value-chains, savings on freight, and lower prices for consumers and access to a large market. Further benefits include improved infrastructure, creation of employment and improved utilization of resources. Direct industry contribution and empirical evidence suggests that opportunities for exports would increase worldwide. Even those industries in Pakistan that are likely to be put at a disadvantage, will have opportunities for sustainability and growth in the long run if managed trade is appropriately negotiated. Pakistan's overall import bill is not likely to be adversely affected by the normalization, though the trade balance may continue to remain in India's favour or even increase substantially.

The findings of this report were limited by budgeting and timing constraints. Naturally, further research and guidance would be indispensable through this transition process. There are numerous other industries not discussed in this report that would present opportunities for expanding Pakistan's exports. The prospect of industry consolidation as a response to a new emphasis on bilateral trade with India is also an area where further research and technical expertise is needed. It is necessary for Pakistani manufacturers and Government to come out on the front foot and actively seek mergers and joint venture opportunities with their Indian counterparts.





As Pakistan and India increase their volume of bilateral trade, land border stations such as Wagah-Attari border are expected to become major trading hubs, especially due to lower freight costs. Therefore greater focus has to be placed on trade facilitation measures not only at the border but beyond the border such as different standards, customs valuation, and non-transparent application of trade defence measures. This paper partially touches on some of the practical steps that can be taken immediately. Several studies show that addressing trade facilitation measures results in a greater economic and trade benefit than reduction in tariffs. Furthermore, there are a number of misconceptions about the normalization of trade between Pakistan and India that need to be cleared up through an extensive awareness campaign.

Report Recommendations

The below recommendations are derived from a combination of analytical research and stakeholder consultations. A more complete circle represents a greater competitive advantage for Pakistan vis-à-vis India.

Automotive Industry	Recommendations	Competitive advantage to India
Passenger cars	❖ Rationalisation of Pakistan's taxation policies, in particular its customs tariff and other auto-related policies	
	❖ Review successful models of regional and bilateral agreements involving auto trade, and adapt those models to local requirements	
	❖ Negotiate with India for reduction in non tariff barriers such as homologation policies	
Tractors	❖ Encourage and enforce Euro II emission standards	
	❖ Expand the production of tractors through early completion of on going projects	
	❖ Allow duty free imports of raw materials through land routes	
Motorcycles	❖ Encourage and enforce Euro II emission standards	
	❖ Focus on where Pakistan has a competitive advantage (local brands with Chinese parts)	
	❖ Target Indian rural consumers who may opt for more economical smaller engines such as the 70cc	
Auto parts	❖ Rationalize tariffs on import of raw materials, parts that are often incorporated in the finished products, dies, and machinery for producing high quality parts	
	❖ Increase quality controls	
	❖ Establish a public-private auto sector-testing centre to ensure that only parts of the highest quality are exported	

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Industry	Recommendations	Competitive advantage to India
Electric fans	<ul style="list-style-type: none"> ❖ Since 80% of the costs are raw materials, enable local industry to procure them at cheaper prices through reduction of tariffs ❖ SMEDA or any other export related organization should assist in developing better engineering designs, regulators, and permanent magnet motors ❖ Organize workshops for increasing awareness for about quality controls and modern assembly techniques 	
Surgical Instruments	<ul style="list-style-type: none"> ❖ Aggressive marketing and branding as Pakistan is already a producer of world class surgical instruments ❖ Since 40% of the costs are imported raw materials (mostly stainless steel), enable the industry to procure at cheaper prices through reduction of tariffs ❖ Encourage the industry to shift from low to high value end products 	
Pharmaceuticals	<ul style="list-style-type: none"> ❖ Strengthen enforcement of Good Manufacturing Practices (GMP) ❖ Encourage and assist major units to get regulatory approvals for their manufacturing facilities from the US FDA or other major agencies ❖ Imports of raw material, medical equipment, packaging material, machinery and those medicines which are not manufactured in Pakistan may be allowed when the negative list is abolished ❖ Import of other medicines may be allowed in a phased manner but no duty concession under SAFTA be allowed so as to offset the cost advantage enjoyed by Indian companies (cheaper materials, machinery and other institutional advantages) 	
Chemicals	<ul style="list-style-type: none"> ❖ Focus on export of chemicals such as Caustic Soda, Soda Ash and PVC Resin where Pakistan has an edge ❖ Negotiate for removal of any non tariff barriers such as the current anti-dumping duties on Soda Ash ❖ For some sensitive industries such as PET Resin, current protection level may have to be maintained 	

Topic	Recommendations
Trade facilitation	<ul style="list-style-type: none"> ❖ Simplification through reduction of multiple checking by different agencies and introduction of single window operations ❖ Harmonization of clearance procedures with those prevalent in sea ports in Karachi ❖ Increase automatic processes ❖ Introduce more reliance on risk profiling
Stakeholder consultations	<ul style="list-style-type: none"> ❖ Launch an aggressive awareness campaign ❖ Follow up similar studies for other industrial sectors ❖ More organization arrangement for public private partnership for trade with India

SECTIONIAL SUMMARIES

Passenger Cars

Within the automotive industry, the major problems arise in the case of passenger cars. The issues facing this industry and recommendations are therefore discussed in some detail.

There are two significant obstacles facing assembly of passenger cars. First, there are the concerns raised by the local car manufacturers. These include the following:

- a. The playing field is not level, as India has many non-tariff and tariff barriers, which will be an obstacle to export Pakistan-assembled cars to India
- b. Indian manufacturers enjoy greater economy of scale and would be able to sell their product at a lower price
- c. Some models of cars produced in India are much cheaper than those in Pakistan. Even with the current tariffs, India would be able to capture a sizeable share of Pakistani market. In return, Pakistan would not gain any access in the Indian market.

Secondly, there are other general issues, which are normally not raised by a majority of the auto industry but they become obvious when the auto policies of both countries are compared. These include the following.

- a. The Pakistani car industry has limited sources from which it can procure its components. Under the Tariff-Based System (TBS) for the auto-sector, assemblers have to source most of their components (other than CKD kits) from local sources. Otherwise they have to pay high tariffs ranging from 35 to 50%. Indian assemblers, on the other hand, can pick their supplier, and thus pay a reduced price and only 10 % duty.
- b. Since all three major car assemblers (Suzuki, Honda and Toyota) depend on their parent company for import of CKD kits, any decision taken by the parent company impacts local production in Pakistan. For example, when Suzuki moved its production from Japan to India, Pak-Suzuki was unable to source its CKD kits and other components from India. It therefore had to stop producing its best selling Alto model. A Similar situation could arise with other makes as India is becoming a manufacturing hub.
- c. Another implication of high dependence on sourcing components from Japan is that due to the rise of the Japanese yen against Pakistani currency, prices of local cars have to be periodically adjusted upwards. In order to check this rise in prices, the Government is compelled to allow import of used cars. This adversely impacts production capacity, which is already rather low at 50%.

As for the first two concerns of the local assemblers listed, namely that the playing field is not level and that Indian manufacturers produce cars cheaper than Pakistan, the following points merit consideration.

- a. Both countries have high tariff and non-tariff barriers for passenger vehicles. Whereas India's barriers are mostly for built-up vehicles, Pakistan's barriers also apply to components and parts.
- b. Local assemblers consider India's policy of homologation (the process of certifying that a particular car is roadworthy and matches certain specified criteria) as a major non-tariff barrier. While this policy is also applied in many other countries, in India the homologation fee is rather high at €200,000. Also the process for obtaining certification is time consuming and complex. Since homologation requirement (the requirement for homologation) is only applicable to smaller cars of the type produced in Pakistan, there is considerable merit to the complaint of Pakistani assemblers that it is a way to restrict the import of cheaper cars.

- c. On the Pakistani side, the Tariff Based System (TBS) can be considered a serious barrier for any new assembler to enter the Pakistani market. Under this system, imports in CKD condition are only allowed to those assemblers who are registered by the relevant federal Government agency. Furthermore, parts/components indigenized by June 2004 have been placed at a higher rate of customs duty. These conditions discourage new entrants.
- d. With a production capacity 14 times larger than in Pakistan (3,880,000 vs. 270,000), Indian car assemblers enjoy a considerable economy of scale. This discrepancy is exaggerated when capacity utilization is considered (50% in Pakistan against 80% in India). Despite this, it should be possible to negotiate mutually advantageous arrangements, as other countries faced by a similar situation were able to do, such as Argentina and Brazil or Canada and the US.

The major disadvantage for the Pakistani car industry is higher tariffs (30 to 50%) on imported auto parts compared to India (10%). Not only does this make the cost of manufacturing cars in Pakistan much higher, but it also lowers quality, as often, local producers are unable to meet international specifications.

Overall, it would not be economical to import cars from India given the current level of tariff protection in Pakistan. A recent study¹ showed that the domestic ex-factory price of the least expensive car (the 796 cc Suzuki Mehran) exceeded Indian prices by about 32%, while the customs duty and other taxes in Pakistan are much higher than this. As for the more expensive models (e.g. the Honda City) the ex-factory prices in the two countries are about the same.

Recommendations

A three-pronged approach is suggested.

- First, rationalisation of Pakistan's taxation policies is needed, in particular its customs tariff and other auto-related policies.
- Secondly, there is a need to look at some successful models of regional and bilateral agreements involving auto trade, and adapt those models to local requirements.
- Finally, prioritisation of those sub-sectors of auto-manufacturing that have a comparative advantage must be carried out. This would have to be a collaborative effort between the Government of Pakistan and the manufacturers.

Tractors

Pakistani tractors can compete in quality and price with global players. Also they are better suited for local market conditions. It is unlikely that Indian tractors would be able to penetrate the Pakistani market to any significant degree.

Pakistani tractors are already being exported to several countries on the basis of their cost competitiveness. If Pakistan were to expand the production of tractors and meet Euro II emission standards, it may have an opportunity to export to India. At the very least, Pakistan will be able to export locally manufactured parts of tractors to India. It is therefore recommended that Pakistan explore liberalizing trade in tractors and tractor parts with India.

¹ Pursell, G et al, "Pakistan's trade policies: future directions", International Growth Centre, Working Paper 11/0361, June 2011

Motorcycles

Branded motorcycles in India and Pakistan are of similar price and quality. As a result, there would be little potential for India or Pakistan to make a significant foray into each other's markets through motorcycles of Japanese brands at the current tariff levels. Pakistan does have a competitive advantage over India for motorcycles assembled with Chinese parts and consequently could penetrate the Indian market. This is especially true for Indian rural consumers who may opt for more economical smaller engines such as the 70cc.

On the other hand, Indian manufacturers may be able to export larger engine motorcycles if duty-free exports were allowed. At the current rates of duty, this would not be feasible. The findings would suggest that Pakistan would stand to benefit from opening up of trade in motorcycles with India and it is worthwhile to pursue a more offensive strategy. They would however, need to meet Indian emission control standards.

Auto Parts

Pakistani auto-parts manufacturers can successfully compete and capture a share of the vast Indian market. For this an enabling environment would have to be created. This would mean rationalization of tariffs on import of raw materials, parts that are often incorporated in the finished products, dies, and machinery for producing high quality parts. Also there will have to be more quality control. A public-private auto sector-testing centre should ensure that only parts of the highest quality are exported.

Electric Fans

Pakistan has successfully built a fan industry to meet all of its local demands. It has also significantly grown in exports to its major markets in Africa and the Middle East. However, domestic demand has slowed down while global demand has increased, especially from neighbouring India. Pakistan's seasonal manufacturing cycle results in a semi-specialized labour force and plenty of unutilized capacity. Opening up trade with India would drive increased investments in technology and labour training by Pakistani manufacturers. It may also lead to industry consolidation as a way to build an economy of scale.

Pakistan's main competitors in the Indian market would be Chinese and Indian manufactures. Pakistan should be able to effectively compete and win a large share of the market from Chinese and Indian manufactures on the basis of better quality and competitive prices. Duty-free import of electric steel sheets and plastics is allowed into Pakistan and if Pakistan were given duty free access to the Indian market, it could easily export fans worth \$50 - 100 million yearly to India over the next 3-5 years.

Surgical Instruments

Pakistan is one of the major exporting countries in the global surgical hand-held goods market. Pakistan's surgical instruments industry has shown steady growth in exports in recent years, reaching US\$300 million in 2011-2012. However, the industry is underutilized and generates far below its potential. Pakistani manufacturers lose out on significant revenues to middlemen in Germany who, after branding and marketing, make substantial mark ups. The industry is focused on the lower end of the market and it requires less investment in technology and specialised labour.

Pakistan's manufacturers have satisfied international quality requirements and have a flexible manufacturing process that can cater to different specifications. Pakistan has the opportunity to significantly grow its industry through exporting to a growing Indian market. Sialkot's proximity to the Indian border and the manufacturers' ability to make direct contacts, eliminating middlemen, should be an incentive for Pakistan to pursue trade negotiations for surgical instruments with India.

Pharmaceuticals

Although a majority of Pakistani manufacturers remain apprehensive about opening trade in pharmaceutical goods with India, the fact is that over the years the government of Pakistan has allowed imports from countries that produce some of the cheapest medicines. These include China, Bangladesh and Hungary. Despite their lower prices the share of medicines from these countries has remained low. For instance, the share of Chinese pharmaceutical products in Pakistan is less than 1%. It is likewise unlikely that products from India will capture any significant share of the Pakistani market.

Furthermore, some Pakistani pharmaceutical manufacturers have recently been successfully competing against their Indian counterparts in many foreign markets. Finished medicines are liable to customs duty of 10% when imported into Pakistan. In some cases such as ampicillin, amoxicillin and cloxicillin, (capsules or syrups), the duty rate is 25%. There is currently no concession under SAFTA on medicines. Thus adequate protection is available against imports from India.

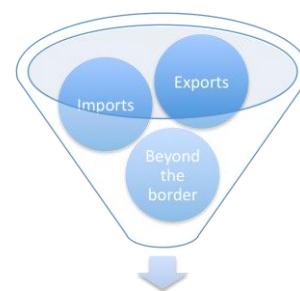
Chemicals

Enhanced trade in chemicals, specifically plastics, provides another opportunity for Pakistan's industry to become more competitive. Amongst organic chemicals, polyethylene and polypropylene are crucial for many industries making plastic goods, particularly those located in Punjab. Currently these chemicals, worth about US\$ 1 billion are mostly imported through sea from the Middle East and then transported by road upcountry. These can be procured at more competitive prices from Indian refineries located near the Wagah border.

On the other hand, Pakistan has recently enhanced its PVC production whereas India is unable to meet its own demand. Pakistan can export its surplus quantity of 70,000 tons to India. Other major organic chemicals where there is a significant potential for trade include p-xylene, o-xylene, ethylene dichloride and phthalic anhydride. Whereas p-xylene and o-xylene are imported in Pakistan, ethylene dichloride and phthalic anhydride are produced in surplus quantities and are in demand in India. As for inorganic chemicals, there is a significant potential for exports of caustic soda, soda ash and hydrogen peroxide from Pakistan while aluminium hydroxide, dithionites, sulphonylates and chlorates have a significant potential for the Indian side.

Trade Facilitation

Of the measures to improve bilateral trade between India and Pakistan, the most important is trade facilitation. The two countries have a common border of about 3000 km but there is only one crossing, Wagah-Attari, through which legal trade of only 137 items is allowed. The total value of trade passing through this point in 2012 was US\$323 million, of which US\$266 million was imports from India and US\$57 million was exports to India. The bulk of the remaining bilateral trade estimated at US\$2.06 billion in 2010-2011 took place through seaports.



Improving trade facilitation

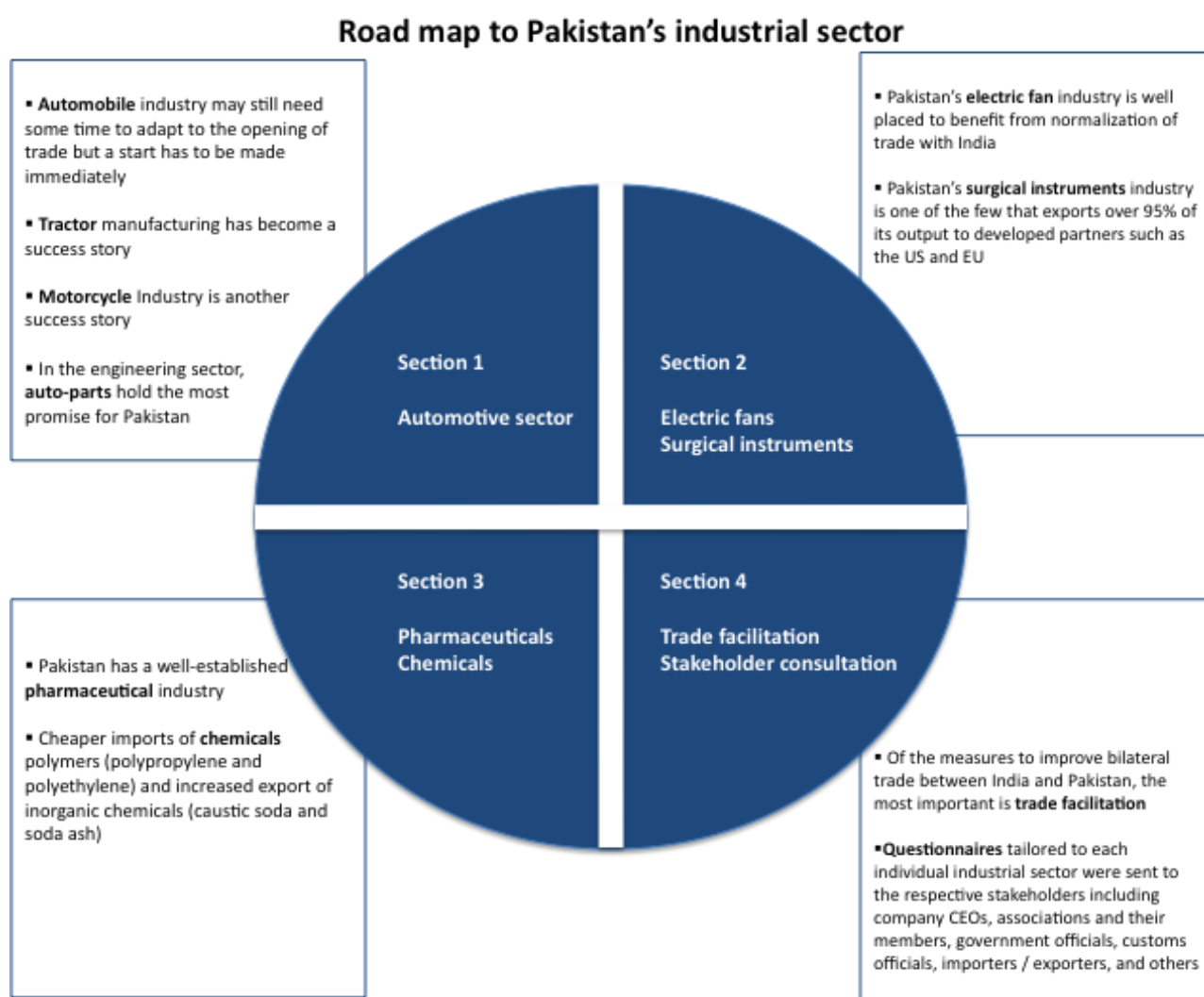
As India and Pakistan increase trade through land, the Wagha-Attari border is expected to become a major hub of their trade, especially due to lower freight costs. However, barriers in trade facilitation remain a major hindrance. Some of the major anachronisms which can easily be observed at this border are the following: multiple agencies overlapping, lack of advance clearance, lack of risk profiling, truck changes, duplication, avoidable fees, and manual processing.

Most of the bottlenecks can be addressed through regulatory measures without any costs. In fact, there would be considerable savings. Trade facilitation measures that can be adopted unilaterally include simplification of processes (remove multiple checking by different agencies, introduce single window concept) and harmonization of clearance processes, advance processing of documents, automation of processes and facilities for payment of taxes in advance. Trade facilitation measures

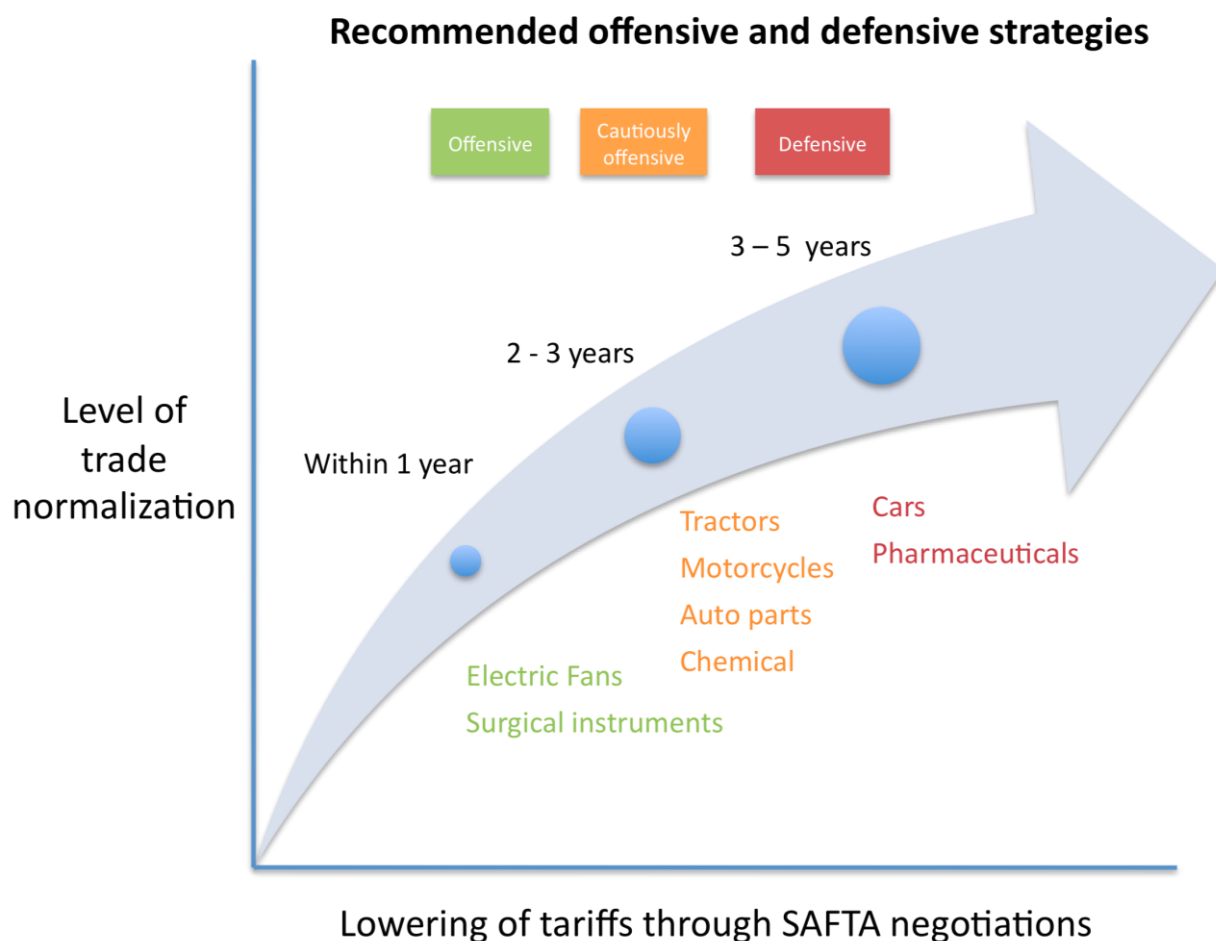
that need to be negotiated and implemented bilaterally include: introducing joint one-stop border systems, allowing transshipment of goods, allowing multiple entry passes for drivers, increasing opening hours from the recently increased 16 to a full 24 hours, introducing risk-profiling, and opening of other border points such as the Husseniwala-Sialkot crossing.

Stakeholder Consultations

In order to receive initial industry feedback two strategies were taken. First, industry agents were directly approached and asked to compile a document illustrating their concerns. Second, where no direct contact was available, questionnaires tailored to each industry were distributed through contact details attained from industry websites. Certain industries had industry organisations. These organisations were consulted for their feedback as well as information on the leading producers in each industry. The list of tailored industry questionnaires is included in the main report.



The chart below provides a summary of offensive and defensive strategies Pakistan can employ through the transition process. These consider Pakistan’s comparative advantage to India in each sector.



The objectives of this report were clear at the outset, with the ITC Terms of Reference articulating exactly the expected outcomes of the report. These objectives are outlined in detail on the next page in the original document provided by the ITC.

POLICY RECOMMENDATIONS – SUMMARY MATRIX

These policy recommendations are addressed to the stakeholder agency, which includes the Ministry of Industries, Ministry of Commerce, Planning Commission, and Federal Board of Revenue.

Challenge	Policy solution / recommendation	Proposed concrete initiatives	Timelines
What steps could be taken to make the auto industry more competitive?	<p>Phase out Tariff Based System so that the auto industry can procure cheaper components</p> <p>Encourage auto-industry association to seek bilateral agreements with its Indian counterpart</p> <p>Ensure compliance with Euro II and other global standards</p>	<p>Reduce customs duty on auto-parts to that prevalent in India i.e., 10% or less</p> <p>Allow import of CKD kits and other parts from India</p> <p>Gradually reduce duty on cars and motor cycles</p> <p>Restrict import of used cars and only allow import of new cars</p> <p>Negotiate removal of tariff on tractors in India</p> <p>Set up a joint public-private sector body to control quality of exported goods</p>	<p>Immediate so that by the time of annual budget in June 2013, the new policy could be set in motion</p> <p>PAMA could be asked to increase their contacts with SIAM (Indian counterpart)</p>
How to make electric fan industry more competitive and gain market access in India?	<p>Improve manufacturing practices</p> <p>Improve capacity utilization</p> <p>Negotiate reduction of customs and other tariffs in India</p> <p>Seek removal of non-tariff barriers</p>	<p>Reduce customs duty on import of raw and packaging materials</p> <p>Make local skill development centers more efficient</p> <p>Enforce quality standards</p>	<p>1-2 years as Pakistani fan manufacturers are relatively competitive</p> <p>Budgetary proposals should be adopted at the time of next budget</p>
How to enhance exports of surgical goods to India?	<p>Improve technologies</p> <p>Increase productivity</p> <p>Shift production from the lower end market to higher value sophisticated products</p> <p>Address compliance</p> <p>Testing and certifications to move up the value chain</p>	<p>Allow import of cheaper raw materials</p> <p>Explore setting up joint ventures with developed countries to be able to export higher end goods to India</p> <p>Set up Public-Private sector testing and standards mechanism</p>	<p>1-3 years but budgetary issues should be resolved at the time of next budget</p>
How to make pharmaceutical industry more competitive and compete against the Indian industry?	<p>Improve quality</p> <p>Encourage joint ventures with the Indian pharmaceutical industries</p> <p>Review the policy of fixing prices for all drugs</p>	<p>Set up a public-private sector regulatory enforcement body to monitor quality</p> <p>Encourage the industry to seek approvals from the international regulatory bodies</p>	<p>2-3 years</p>
How to increase bilateral trade in plastics and chemicals?	<p>Identify potential winners and encourage their exports</p> <p>Allow duty free import of plastics that are not</p>	<p>Ministry of Industries to prepare a list of products that Pakistan is in a position to export</p> <p>Reduce duty on polyethylene and</p>	<p>1-2 years</p>

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	produced locally	polypropylene	
How to improve trade facilitation across land borders?	Eliminate multiple checks Improve infrastructure	Replicate customs procedures applicable for exports and imports from Karachi port Establish single window operations	Start implementing immediately and monitor progress over the next 2 years