Chapter 17

Pakistan: South Asia Trade and Non-tariff Barriers

Usman Khan

17.1 Introduction[1]

The purpose of this chapter is to analyse, from the perspective of Pakistan, the future of South Asian integration in light of the changing patterns of trade. The scaling down of tariffs has shifted the focus of researchers working on the South Asian Free Trade Area (SAFTA) towards the plethora of non-tariff barriers (NTBs). The member countries of SAARC have been forthcoming in reducing their tariff barriers as agreed under SAFTA. In fact, India has implemented all of the tariff reductions that were agreed under the SAFTA, well before the deadline. Pakistan, Bangladesh and Sri Lanka have also been responsive in reducing tariff rates in compliance with this agreement. However, this liberalisation of tariffs has had little impact on trade and integration within the region. Whereas, India has allowed duty-free imports for all products except for the ones specified on the sensitive/negative list, it has conversely put in place harsh requirements, which have in turn created procedural complexities, making trade flows unviable.

This chapter makes the case, using Pakistan as an example, that NTBs have become the major obstacle to trade flows. Reducing tariffs and NTBs would provide a stimulus to trade, and having the capacity to supply in accordance with demand is what triggers the real flow of trade. The export competitiveness of a country is extremely important in determining how much trade it can achieve. Within South Asia, India is a clear success story. India has capitalised on its large labour base and large domestic market and converted these into a competitive advantage. If trade and integration is to increase within South Asia then India will have to play a generous role in building capacity of other member countries. The strategy played successfully by the ASEAN region certainly deserves some attention by the policy-makers in South Asia. China being in the lead has consistently fragmented its production by shifting production of various parts to least developed countries while it has itself relied on producing the final goods. In doing so, China has consistently maintained a trade deficit with the ASEAN countries; however, it has had a significant trade surplus against the USA. This strategy has resulted in a high degree of integration, economic betterment and technology spillover within the region and a significant reduction of NTBs. In certain products, India can certainly take the lead and develop regional value chains that will help produce goods that will not only be competitive globally, but will also enhance the level of trade within the region.

In the light of the above argument, this chapter examines the prospects for vertical integration of industries in South Asia. This is done by calculating a time series for a weighted Grubel–Lloyd Index using the trade data from the UN Commodity Trade (Comtrade) Statistics. The index has been calculated for trade between Pakistan and India, Pakistan and Sri Lanka, and Pakistan and Bangladesh. The evidence suggests that currently very limited intra-industry trade exists between these trade partners. It was also found that a higher degree of intra-industry trade existed in textile and yarn, possible because Pakistan has a large cotton base and a significant quantity of exportable yarn production. Again, a strategy to promote product fragmentation/intra-industry trade comes with its costs. Intra-industry trade within the region is only beneficial if the size of trade creation is greater than the size of trade diversion.[2] Studies have shown that the size of trade diversion in most cases was larger than size of trade creation for most of South Asian partners. Trade diversion is a cost that regional integrations normally have to bear. However, the cost of integration can be minimised if a friendly environment for investment is made available within the region. An attractive investment environment within the region is essential to enable businesses to engage in regional activity and develop regional value chains. Existing literature has discussed that investment flows within South Asia have been on the lower side, again limiting the extent of integration and trade potential.

Finally, for SAFTA to succeed it is imperative that tariff reductions be made in line with the original agreement, NTBs be marginalised and greater scope for investment flows be created to assist firms in developing forward and backward linkages. This chapter also strongly recommends that an agreement on regional investment must follow as part of implementing SAFTA. These elements combined can significantly trigger trade and integration within the region.

17.2 Integration efforts in South Asia

Intra-regional trade in South Asia constitutes only 5 per cent of total trade of the region. The role of politics and protectionism in South Asia are two of the commonly cited reasons for the low levels of intra-regional trade. During the late-1940s, trade among South Asian countries was significantly higher, since most of the South Asian countries were part of British India. There were no tariff barriers, there was a single currency and goods were traded freely. Post-independence, the majority of Pakistan's imports were sourced from India and approximately two-thirds of Pakistan's exports went to India. However, India and Pakistan's bilateral trade relations suffered greatly due to bitter territorial disputes, currency valuations and with the controversies surrounding water distribution. Second, South Asian countries pursued economic development by adopting import substitution rather than export promotion strategies, keeping trade as a low percentage of national production and with little emphasis on regional trade.

Therefore, up until the 1970s, high tariffs and NTBs, pervasive state intervention in the economy, disincentives to foreign investment and stringent foreign exchange policies have rendered South Asia as the least-integrated economic region globally. In addition, border disputes, political tension, and import substitution and protectionist

growth strategies in India and Pakistan, the two largest economies in South Asia, have resulted in low levels of bilateral trade.

The process of preferential trade liberalisation has gradually been introduced in South Asia since the establishment of the regional forum South Asian Association for Regional Cooperation (SAARC) in 1985. Currently, the agreement of the South Asian Free Trade Area (SAFTA) is being implemented. SAFTA has been ratified by all SAARC member states. SAFTA's objectives are to promote and enhance mutual economic co-operation in order to fully realise the region's potential for trade and development.

The SAFTA Agreement also aims to reduce the costs of regional trade by calling for the adoption of trade facilitation measures including harmonisation of standards and mutual recognition of test results, harmonisation of customs procedures and better co-ordination in strengthening transport infrastructure tariffs. The tariff reduction programme is phased, from average weighted tariffs of no more than 20 per cent within two years and 0–5 per cent within five years after completion of the first phase for India, Pakistan and Sri Lanka, with the aim of achieving agreed tariffs on imports no later than 1 January 2009. These targets have been achieved in principle. Bangladesh, Bhutan, Maldives and Nepal are required to have average weighted tariffs of no more than 30 per cent within two years and eight years for the second downward adjustment.

The rules of origin (RoO) is an important provision of the free trade agreement (FTA), which requires the domestic value addition (DVA) of 40 per cent from the non-LDC member countries of India and Pakistan, 35 per cent for Sri Lanka and 30 per cent for LDCs, in combination with a change in tariff heading (CTH) classified at the Harmonized Commodity Description and Coding System (HS) code four-digit level. The SAFTA RoO is similar to the RoO of bilateral FTAs in the region. The most critical provision in SAFTA is the one dealing with sensitive sectors (see Table 17.1). It identifies sensitive industries that should be protected from competitive neighbours. The SAFTA treaty provided room for negotiations to ensure a maximum ceiling on items that can be placed under the negative list by each member country. It was expected that a limited approach would be adopted limiting the negative list to 10 per cent of tariff lines out of a total of 5,224 tariff lines at the HS six-digit level. However, the final decision was to retain a negative list of approximately 20 per cent

Table 17.1 Trade restrictions under SAFTA

	Value of imports from SAARC subject to SL (%)	Value of exports to SAARC subject to SL (%)
Bangladesh	65	22
India	38.4	56.5
Maldives	74.5	57.6
Nepal	64	46.4
Pakistan	17.2	34
Sri Lanka	51.7	47
Total	52.9	

Note: SL = sensitive list
Source: Weerakoon (2010)

of tariff lines. This implies that the actual trade coverage of the negative list of each country is quite high. The provision that SAFTA signatories will review negative lists every four years in Article 7 (3b) is vague and is not formal or binding in requiring the negative list to be reduced over time. By comparison, negative lists of bilateral FTAs in the region are more limited. Mapping the sensitive list of each country to their imports from South Asia reveals that approximately 53 per cent of the total import trade among South Asian countries is excluded from the liberalisation of tariffs proposed under SAFTA.

The SAFTA Agreement has provisions to deal with para-tariffs and NTBs, however, there are no explicit commitments to be fulfilled by countries. The SAFTA Agreement has no provisions to eliminate NTBs on items where tariff reductions are made and NTB issues are subject to negotiations. The SAFTA treaty has been confined to trade in goods. SAARC has taken the initiative to commission a joint study to incorporate services and investment into SAFTA (Weerakoon 2010).

Even though the SAARC is the world's largest regional organisation in terms of its population, the SAFTA Agreement's impact on trade has been negligible, which is invariably attributed to the restrictions imposed within the agreement. In all fairness, the SAFTA Agreement is still in its initial stages; the impact of SAFTA can only be analysed over a longer time period.

India is the strongest trading partner in the region. It not only has a large amount of trade with Bangladesh and Sri Lanka but also Pakistan. Moreover, for all these three countries (Pakistan, Bangladesh and Sri Lanka) the trade balance has always been significantly in favour of India. Pakistan, Bangladesh and Sri Lanka have historically maintained large trade deficits against India, which has left their respective commerce ministries skeptical about opening up to trade with India. Traditional trade theory (Ricardian and Hecksher-Ohlin) predicts that there is limited scope in improving intra-regional trade given the fact that all the countries have relative comparative advantage in producing similar goods, i.e goods that require a large low-cost labour force such as textiles, garments, light manufacturing and agriculture products. India's high degree of export similarity within South Asia has reduced the opportunities for other member countries to explore the large Indian markets. This high degree of export similarity has led the member countries to adopt protectionist policies using similar tariff structures or by advocating for an extremely large negative list.

In Pakistan there is a large group of people who believe that opening full trade with India is risky, as Indian products will flood local markets and the domestic industry will not be able to compete. On the other hand, this argument is also contested by some sectors in Pakistan which feel that trade with India can help to build a stronger industrial base and will make it more competitive. These proponents often talk about the technology spillover effects and investments that can be made. It is argued that if Pakistan has to defend its global positioning and increase its market size, a shift in its business philosophy is required. Pakistan will have to focus on building its competitive advantage. It will have to focus on research and development, technical innovation, product development and also venture into

brand and market development. There is a lot that Pakistan can learn from India and, hence, a more relaxed trade environment can be extremely useful in attaining this shift. Indian industry has mastered the technique of serving consumers with low purchasing power and the majority of them are living in rural areas where distribution systems are dismal. Industry has been able to innovate within the constraints and has developed products and services that match local needs. Tata Motors' Nano Car for US$2,000 and Boyce Manufacturing's US$70 fridge that runs on batteries are two of the many success stories from India. This capability to slash prices and radically change the way products are made and delivered is India's biggest competitive advantage. As Western economies struggle to fight the global recession, Indian manufacturers have found a large domestic unmet demand for low-priced but innovative products. In addition, India has also succeeded in acquiring several internationally established brands, taking its own low-cost goods and selling them under these established brands, i.e. a strategy of reverse acquisition. This presents a significant opportunity for Pakistan to exploit similar comparative advantage conditions to competitive advantage and begin to upgrade its industrial and trade potential.

SAFTA, compared with other bilateral trading agreements (such as the India–Sri Lanka Bilateral Free Trade Agreement (BFTA) and the Pakistan–Sri Lanka BFTA) signed by South Asian countries within the region, is not an 'ambitious' FTA, owing to the fact that member nations retain sensitive lists of commodities, and that services trade and foreign direct investments are excluded from the ambit of the agreement. The RoO may seem stringent, where LDCs have to comply with 30 per cent domestic value addition criteria. On the contrary, a low level of domestic value addition criteria has been set under BFTAs in South Asia. Second, the Trade Liberalization Programme (TLP) under SAFTA does not have commitments for an immediate reduction of tariffs to 0 per cent compared with BFTAs, which have reduced tariffs to 0 per cent for a substantial number of products. The extensive negative list of member countries for trading is also a structural rigidity (Mahbub Ul Haq Human Development Center 2010). Furthermore, the scope of SAFTA in enhancing intra-regional trade in South Asia is under question since SAFTA is emerging under myriad bilateral, subregional and multilateral trade agreements.

The implementation of SAFTA has also faced political impediments. Pakistan and India's political divide has resulted in a delay in Pakistan granting India most favoured nation (MFN) status (the decision was made only in early 2014). Political issues have taken precedence over economic interests; however, the significance of a unified South Asian region under SAARC, and its trade initiative SAFTA, is apparent from the interest shown by China, Japan, South Korea and the USA in the SAARC forum. To date, nine countries have been granted observer status in the SAARC forum, starting with China and Japan, followed by Australia, the European Union, Iran, South Korea, Mauritius, Myanmar and the USA.

The other main area of progress is the sensitive list, and how India undertakes liberalisation ahead of schedule. As mentioned previously, India is viewed as the driving force behind the successful implementation of SAFTA, given its significantly

asymmetric nature of economic power. Given the rapidly changing pattern of trade and investment linkages of India across the wide Asian region, the prospects of integration in South Asia have to be viewed from a broader perspective. This perspective should take into consideration India's own economic interests and growing economic ties with the ASEAN region, how these can relate to the South Asian region, and how other South Asian economies are adapting to newer challenges of reduced tariffs, but more stringent TBT and SPS measures, export competitiveness and supply-side constraints.

India's pattern of import and export trade suggests that India's economic interests lie outside of South Asia. While India's exports to South Asia have stagnated at 5–5.5 per cent of its total exports, its imports in the region are around 1 per cent of its total imports. By comparison, India's trade with ASEAN has been growing at the rate of 30 per cent from 2003–08 (The ASEAN Secretariat 2008), where India is considered as one of ASEAN's main trading partners. This demonstrates India's 'Look East' policy where the Indian economy is developing complementarities with East Asian economies in knowledge-based segments such as microchips, information technology, etc. In addition, Pakistan also witnessed a 20 per cent increase in trade with ASEAN from 2003–08 (The ASEAN Secretariat 2008), where Pakistan is also considered as one of ASEAN's main trading partners. Therefore, what can be observed from the trading patterns of South Asian economies is that there is a strengthening of strategic links with East Asia and a stagnation of trading patterns in intra-South Asian trade (Weerakoon 2010).

17.3 Pakistan's trade relations with South Asia

17.3.1 Pakistan's trade profile

Throughout its history, Pakistan has experienced periods of high growth interrupted by shocks and crises, including natural disasters, and later followed by stagnation. Pakistan's top industries are textiles and apparel, food processing, pharmaceuticals, construction materials, shrimp, fertilizer and paper products. Exports for Pakistan's commodities have traditionally been concentrated in a few markets (such as Germany, Hong Kong, United Arab Emirates, United Kingdom and United States) but there has been a gradual shift to a greater geographical diversification, with the concentration in the traditional markets falling 47.2 per cent in 2006 to 35.3 per cent in 2011. Total exports for 2011 were US$25 billion and consisted of textiles (garments, bed linen, cotton cloth and yarn), rice, leather goods, sporting goods, carpets, rugs, chemicals and manufactures. The major trading partners, in terms of their share in Pakistan's exports in 2011, were United States (16%), United Arab Emirates (7.3%), Germany (5.1%), United Kingdom (4.9%) and Hong Kong (2%). Pakistan's total imports in 2011 were equivalent to US$40 billion, and consisted mainly of petroleum, petroleum products, machinery, edible oils, pulses, iron and steel, and tea. The main trading partners in 2011, in terms of their share of Pakistan's imports, were Saudi Arabia (11.3%), Kuwait (8.2%), United States (4.5%), Japan (4.1%), Germany (2.3%), and United Kingdom (1.6%). None of the South Asian countries are in the Pakistan's top seven trading partners.

Considering the composition of exports, primary commodities grew from 11 per cent in 2002 to 18 per cent in 2011; this can be accounted for by improved processes in the production of cotton and higher international demand. For manufactured goods, these constituted 75 per cent of Pakistan's exports in 2002 but the share had declined to 69 per cent in 2011. This decrease indicates that Pakistan has not moved towards technology and innovation-based manufacturing production and exports. The share of the remaining export sector, semi-manufacturing products, also declined.

17.3.2 Pakistan–Bangladesh trade relations

Textile yarn, fabrics, made-up articles, etc. are the largest exported and imported manufactured goods between Pakistan and Bangladesh. Pakistan has a favourable balance of trade with Bangladesh. Pakistan's share of exports and imports from Bangladesh is also very small. Despite the export potential, under SAFTA Pakistan is not getting any concessions on items 65 (SITC Rev 3). More importantly, if we look deep into the trade figures, the main trade is in yarn, as it serves an important input into the value-added textiles industry of Bangladesh. Bangladesh does not have the complete textiles value chain and hence has to rely on other countries for raw materials. However, the value-added textiles sector has seen a significant boom in Bangladesh and this has added to the high demand for exports. However, Bangladesh is fast developing the capacity to produce its own yarn; in fact some of the Pakistani industry has shifted over to Bangladesh. As this transition matures this figure is also expected to decrease. The second largest item of export from Pakistan to Bangladesh is machinery. However, the size of this export is only a minimal amount of total Bangladeshi imports.

There is significant opportunity for Pakistan to enhance its exports of synthetic filament to Bangladesh; however, this is included in the sensitive list. In respect of woven fabric of synthetic staple fabric and yarn of synthetic staple fibres there can be significant export potential but these products are all included in the sensitive list of Bangladesh. Parts and accessories for motor vehicles and special purpose motor vehicles are also included in the sensitive list of Bangladesh.

Bangladesh has made significant progress in liberalising its trade regime. Customs duty rates have been reduced, the import permit system is now automatic and the cumbersome procedure for opening letters of credit has been simplified.

However, in terms of NTBs Pakistani exporters have identified the following constraints that limit export to Bangladesh.

- ***Lack of harmonisation of standards*** – The Bangladesh Standards and Testing Institute (BSTI) was created through an ordinance (Ordinance XXXVII 1985) as a result of the merger of the Bangladesh Standards Institution and the Central Testing Laboratories. Bangladesh has developed a host of product-wise standards that are mandatory for any product to meet. Exporters have complained that these standards are on the stricter side and often make it difficult to export. Furthermore, the exporters also face information gaps. The amendments made in the standards, the requirements of the standards, etc. are not readily available on

the internet. This information is normally requested through a written request. All these activities take time. If the standards are harmonised with international standards they will become easier to follow. The information gap is a big hurdle. For example, 10 per cent of total fan exports of Pakistan go to Bangladesh. The electric fans have to comply with BDS 818 standard, which requires several tests and safety precautions. The exporters do not complain on the difficulty of obtaining these certifications, instead, the problem lies in acquiring all the information required.

- ***NTBs and para-tariffs*** – Some exporters have complained about requirements that products face once they enter into Bangladesh. An often-quoted example is the industrial development charge that they face. In addition, there is a product labelling policy for chemical, agriculture and food products. This policy has again slowed down the pace of exports from Pakistan and has increased costs due to development of new labels and packaging.
- ***Transportation*** – There are no direct shipping lines between the two countries and the option of a land route passing through India is not yet available.
- ***Sensitive list*** – Bangladesh under SAFTA has included 1,245 items in its sensitive list. This large list, by any standard, covering many items in which Pakistan has comparative advantage significantly lowers the possibility of exports from Pakistan.

Other trade restraints include a lack of banking facilities and a robust trade dispute resolution mechanism.

On the other side, exporters from Bangladesh also face technical and quality standards when sending their products into Pakistan. A major problem area that has been highlighted is Bangladeshi pharmaceutical imports to Pakistan that have been restricted, as the registration process is governed by a very strict law. The Government of Pakistan has exempted all domestically produced pharmaceutical-related inputs from its General Sales Tax (GST). Imported pharmaceutical inputs are subject to a 10 per cent customs duty but are also exempt from payment of GST. In addition, visas for entry into Pakistan are only obtained for specific cities. Similar to Pakistani exporters, Bangladeshi exporters also face constraints due to lack of information, absence of direct shipping links and cargo flights. Moreover, Pakistan has not offered the special and deferential treatment accorded to Bangladesh as an LDC. Exporters suffer from the non-recognition of testing institutes and laboratories for conformity assessment. Pakistan also maintains a large sensitive list for Bangladesh which hinders the trade potential.

In January 2000, the Pakistani government began implementing a transactional valuation system, pursuant to which 99 per cent of import valuation is based on invoice value, in accordance with the WTO's Customs Valuation Agreement. However a number of traders in food and non-food consumer products have reported experience of irregularities and deviations in the application of that system. On 30 June 2005, Pakistan Standards and Quality Control Authority (PSQCA) established over 21,000 standards (including 15,500 ISO standards) for

agriculture, food, chemicals, civil and mechanical engineering, electronics, weights and measures, and textile products. However, not many sources have stated these to be a problem due to inadequate capacity for strict implementation and lacking infrastructure to monitor.

17.3.3 Pakistan–India trade relations

There was a major political breakthrough on trade between India and Pakistan in 2011. During the course of the year, Indian and Pakistani government officials held several high-level meetings aimed at improving trade relations: the respective secretaries of commerce met twice (in April and November) and the ministers of commerce met in September in Mumbai. The two countries' Prime Ministers also discussed trade issues at the Seventeenth SAARC Summit in Maldives November 2011.

On 2 November 2011, the Pakistani government announced it was finally ready to grant MFN status to India, and thereby replace the positive list of items that could be imported from India with a negative list of items that could not be imported. The cabinet's decision was a turning point in trade relations between the two countries, and finally fulfilled Pakistan's obligation as a member of the WTO to reciprocate India's granting of MFN status to Pakistan.[3] Following this decision and the visit of the Indian commerce minister, accompanied by a delegation of Indian business leaders in early 2012, Pakistan's cabinet announced on 29 February 2012 that MFN status with India would become operational in 2013. In the interim, a negative list of 1,209 items replaced the positive list of 1,946 items. As a result, more than 7,000 items could now be imported from India. At the end of 2012, the negative list was to be further replaced by a small list covering items normally restricted by all countries, relating to security, religion and health, etc. All other items would be governed by MFN requirements. Despite some initial protests from more nationalist segments against granting MFN status to India, Pakistani business people generally welcomed the decision, as did Indian business and government leaders.

Even though both countries are members of the SAFTA, trade between the two countries is unnaturally low.[4] Total trade (exports plus imports) between the two countries in 2011 amounted to a little more than US$2.5 billion, up from a paltry US$750 million in 2005.[5]

There have been several positive developments in bilateral trade relations recently. In March 2013, the Commerce Ministry of India announced that it will reduce its SAFTA sensitive list of imports from Pakistan at the HS six-digit level to 100 from 634.[6] However, of these 100 items, 75 will be from the agriculture sector and the remaining from tobacco and liquor. This still leaves Pakistan with a limited range of products to export to India. The precise contents and the timetable for the revised sensitive items list are yet to be made public.

A further positive development includes the formal establishment of the India–Pakistan Joint Business Council on 15 March 2013. The Council will seek to increase bilateral trade and investment between both the countries. The body is being set up under the two Ministries of Commerce and Industry and will constitute 15 business executives from both sides. The Council is expected to meet every six months with its

first meeting planned for August 2013. It is expected that this body will act as a focal lobby group to work with government on both sides to normalise trade relations. The Council will be the advocating force on implementing the MFN regime with India and streamlining Indian NTBs faced by Pakistan.[7]

Following the ministerial-level meetings, several Joint Working Groups were established to examine trade in goods, as well as services and investment. Agreement was reached on the following important issues:

- As agreed by the Secretaries of Commerce last year, a new visa procedure has been developed and signed by the political leadership of both countries. There has been much headway made in terms of ensuring that traders and members of the business community are able to travel easily between the two countries in an attempt to strengthen commercial ties through multiple-entry and multiple-city visas with no entry/exit restrictions.
- Tedious customs procedures are addressed in the Customs Co-operation Agreement (pact approved and signed, but not notified), reducing the arbitrariness of decisions by customs officials on both sides of the border.
- Multiple SPS standards have been addressed by the Mutual Recognition Agreement (pact ready but not approved) which is meant to reduce unnecessary delays in getting approval for quality certifications.
- Redressal of Grievances Agreement (pact undergoing revisions) designed to make the process of resolving trade disputes by the respective governments both simpler and speedier.
- However, the deadline of December 2012 for formally granting MFN and more importantly phasing out the negative list has passed. As such, the current list still contains 1,209 items. Pakistan's Ministry of Commerce, in its media communication, has not given a new date for implementing MFN status with India and eliminating the negative list. Many reasons have been advanced for this delay.

NTBs between India and Pakistan

A firm-level survey was conducted by Taneja (2007) in order to identify NTBs between India and Pakistan. The survey was conducted in Amritsar, Delhi, Mumbai, Kolkata and Indore in India, and in Karachi, Lahore and Islamabad in Pakistan. Interviews were conducted with key stakeholders (exporters, importers and freight forwarders/ clearing agents) in both countries. A total of 137 respondents in India and 109 in Pakistan were interviewed during August 2006 to January 2007.

This study focused on identifying TBT and SPS-related barriers, and whether they had been applied in a non-discretionary or trade-restrictive manner. The broad categories of barriers identified in the study include the positive list approach, TBT and SPS measures, trade facilitation and customs procedures, financial measures, para-tariff measures and visas.

TBT and SPS measures in India and Pakistan

The Bureau of Indian Standards (BIS), Ministry of Food and Consumer Affairs is the main standard setting body in India. In Pakistan, the Pakistan Standards and Quality Control Authority (PSQCA) is the sole national standard setting body.

The functions of PSQCA include the establishment and enforcement of national standards, registration of inspection agencies, and assessment of industrial raw materials and finished products for compliance with international standards. According to the United States Trade Representative (2009), PSQCA had adopted over 27,165 standards (including 15,000 International Organization for Standardization (ISO) standards) for agriculture, processed food, chemicals, civil and mechanical engineering, electronics, weights and measures, and textile products. Current estimates indicate that there are 15 certification bodies operating in Pakistan, and close to 2,700 enterprises have been issued ISO 9000, ISO 14000 and Occupational Health and Safety Advisory Services (OHSAS) 18000 certificates. (Initially there were 5,000 but many of the enterprises dropped out of the programme.) All of the certification bodies operating in Pakistan are foreign-based (United States Trade Representative 2009).

Under the Consumer Protection Act, 1986 in India, Consumer Redressal Agencies at the district, state and national levels (also known as consumer courts) protect and promote consumer interests. The implementation of standards is often perceived by Pakistan as NTBs. Consumer protection in Pakistan is still in its infancy and the prevailing trade-related SPS legislation fails to address potential hazards in food supply chains and in processing, such as biological, chemical and environmental contamination. In addition, TBT requirements such as labelling only include the list of ingredients, label terminology and name of producer or manufacturer (Siddiqui 2006). The lack of effective consumer protection laws couples with implementation challenges in domestic standards.

Pakistani exporters face many challenges in complying with the multiple domestic India standards, rules, regulations and requirements of India enforcement agencies. The lack of transparency and informational flows between the two countries further exacerbates the situation. A lack of testing facilities at the land border also causes unnecessary delays.

Pakistan's export interests are in textile and agricultural products. First, India applies import restrictions on these two items through TBT and SPS measures, which are applied in a non-discriminatory manner and are General Agreement on Tariffs and Trade (GATT)-compatible import controls; however, due to the supply-side constraints of Pakistani exporters and their lack of capacity to meet Indian compliance requirements, TBT and SPS measures act as protective NTBs. Second, as far as tariff concessions under SAFTA are concerned, despite granting MFN to Pakistan India has 20 per cent of the items on its sensitive list in the agricultural sector and 34 per cent in textile products. India has 884 items under its negative list and Pakistan has 1,183 items.

Apart from policy, tariff concessions and implementation challenges there are also problems related to the acceptance and confirmation of letters of credit or contracts

offered by banks, but payment guarantees are not ensured. Subsequent defaults in payments are not settled through a formal dispute settlement. The Asian Clearing Union (ACU) was set up in 1974 with eight members, India, Iran, Nepal, Pakistan, Sri Lanka, Bangladesh, Myanmar and Bhutan. All payments related to bilateral trade are made through the ACU. High transaction costs and inefficiency exist in the ACU, particularly in terms of the time taken to settle transactions. There is also a lack of other alternatives, since Indian banks are not allowed to operate in Pakistan, and vice versa.

Para-tariff measures between India and Pakistan are applied in a non-discriminatory manner with high duties; for example, India imposes a countervailing duty of 16.3 per cent on most items, a special countervailing duty of 4 per cent and an education cess of 2 per cent. Pakistan imposes a sales tax of up to 15 per cent and a withholding tax of up to 6 per cent. In addition, for selected products that have a sales tax a federal excise duty is also charged. Pakistani exporters are required to state the minimum retail price on packaged foods but they are unable to do so because they do not always have information on distribution costs that would be incurred in India. Due to the presence of inter-state taxes imposed on the movement of goods in India, Pakistani exporters' costs increase and the costs of their exports become prohibitive. In addition, both India and Pakistan follow restrictive visa regimes. Table 17.2 shows the commodity-wise proportion of tariff lines in the sensitive list between India and Pakistan (Taneja 2007).

In India there are multiple ministries/departments responsible for regulating imports. There are also multiple official publications/compendiums covering information on tariffs, tax rates and procedural formalities for exporters. There are separate tariff and federal excise tax schedules, public notifications and notices that determine current

Table 17.2 Commodity-wise proportion of tariff lines in sensitive list

	Share of tariff lines (%)	
Commodity group	**India**	**Pakistan**
Live animals, animal products	3.0	1.7
Vegetable products	20.2	4.2
Animal/vegetable fats, oils, waxes	3.6	2.4
Prepared foodstuffs, beverages, spirits, tobacco	7.6	3.0
Chemical and allied industries	3.8	6.3
Plastics, rubbers	10.7	9.8
Wood pulp, paper, paperboard, scrap/waste paper	1.5	4.0
Textiles and textile articles	34.2	24.1
Footwear, headgear, umbrellas, walking sticks, riding crops	1.9	1.3
Stone, plaster, cement, asbestos, mica, ceramic, glass, glassware	1.0	5.0
Base metals	6.8	11.0
Machinery, mechanical appliances, electrical appliances	3.0	17.2
Vehicles, aircraft, vessels, transportation equipment	0.5	6.0
Miscellaneous manufactured articles	0.3	0.9

Source: Taneja 2007

tariff and tax rates. The decentralised nature of tariffs and the procedural regime, and the presence of an anti-dumping measures, act as an NTB and result in uncertainties and delays. The 4 per cent countervailing duty imposed on all imports, in addition to customs duty, deters imports and makes them uncompetitive. Section 2(41) and section 14(1) of the Indian Customs Act provide officers with the discretion to evaluate goods beyond international norms and practices and this results in multiple queries on bills of entry on Pakistani exports. The Indian Customs Valuation methodology does not reflect actual transactions values and effectively raises tariff rates. In India each state exercises its own rules regarding the inter-state movement of goods, which are subject to further inspection and taxes. These procedures and expenses are to be borne by the exporters. Since Indian banks do not accept letters of credit issued by Pakistani banks, transactions are settled through the ACU. This mode of payment acts as an NTB due to inefficiencies within the ACU discussed earlier.

For the export of products including cement, gelatine, condensed milk, electrical appliances, mineral water, steel products, leather products, X-ray equipment, dry cell batteries, thermometers, helmets and gas cylinders, Pakistani exporters are required to obtain a licence from the BIS in addition to the application/processing charges, which requires the payment of costs of inspection visits from India. These licences are required to be renewed annually for new inspection/testing of samples, raising costs of exports and affecting their competitiveness.

The process of acquiring an import permit for export of primary agricultural products to India is complex and lacks transparency. India imposes import licences on 600 items to ensure protection for human, animal and plant life health. Nearly all livestock agricultural and food products require an SPS or sanitary certificate and import permission issued under the general supervision of the Ministry of Agriculture. All food products imported to India are subject to prevention of food adulteration rules, standards and measures, which also include orders such as the Meat Food Product Order 1973, the Plants Fruits and Seeds Order 1989 and the Livestock Act. In addition, all poultry, dairy products and meat (frozen, chilled or fresh) require import permits from the Department of Animal Husbandry and Dairy. Processed food products have to comply with the Prevention of Food Adulteration (PFA) Act 1954 that requires shelf life to be not less than 60 per cent of original shelf life at the time of import. Leather, leather goods and melamine products also require laboratory testing. Samples of export consignments are sent to testing laboratories far away from customs points. Pre-packaged products, such as processed foods, cosmetics, toiletries, spices, etc., have to carry the declarations in accordance with Rule 32 of the PFA Act. This rule has 30 provisos and provisos within provisos: (a) name and address of the importer; (b) generic or common name of the commodity packed; (c) net quantity in terms of standard unit of weights and measures, and if the net quantity in the imported package is given in any other unit, its equivalent in terms of standard units shall be declared by the importer; (d) month and year of packing in which the commodity is manufactured or packed or imported; and (e) maximum retail sale price at which the commodity in packaged form may be sold to the ultimate consumer. This price shall include all taxes local or otherwise, freight, transport charges, commission payment to dealers, and all charges towards advertising, delivery, packing, forwarding and the like, as the case

may be. The requirements (b), (c), and (d) are justifiable, but (a) and (e) pose great challenges to Pakistani exporters.

Although Indian authorities and independent scholars refer to these SPS measures and rules as fair and in accordance with the WTO Agreement (Taneja 2007), the detailed multiple rules and regulations are often implemented arbitrarily and without transparency at the discretion of the customs authorities, have lengthy procedural formalities, are complex, cause delays and undesirable demurrage, discourage Pakistani exporters and render Pakistani exports to India uncompetitive (Sohail 2010).

Textiles and textile products also have trade restrictive measures applied to the use of AZO dyes in the manufacture of fabrics. A pre-shipment inspection certificate from a textile testing laboratory accredited to the National Accreditation Agency of the country of origin is required and the failure to provide certification requires testing from the notified agencies in India for each and every colour of every consignment. These restrictions are even applicable to EU-accredited labs, which causes delays and additional costs. The Textile (Consumer Protection) Regulation 1988 imposes strict marking requirements for yarns, fibres, and fabrics imported to India. The consignments are examined 100 per cent for verification. These regulations essentially work as quantitative restrictions because there are no written instructions, rules or guidelines for customs officials. Woollen textiles require a certificate of origin even if no concessions are being claimed, accompanied by a certificate from brand owners that the product is genuine and that the exporters and/or manufacturers have the authority to use the brand name. Textiles and textile products are also subject to additional duty of excise and the commodity cess, which are levied as additional duty of customs (Sohail 2010).

Pharmaceutical products have stringent requirements for the registration of the drug with the Central Drug Standard Control Organization. All foreign manufacturers must register and subject their premises to inspection in accordance to the rules prepared by the BIS.

Consumer goods imported in retail packaging are subject to the Directorate General of Foreign Trading (DGFT) notification 44(re)/24.11.2000 on labelling and marking rules for imports issued on 24 November 2000 stipulates that maximum retail price, generic name of product, month and year of entry in trade channel, importer name and address and quantity in standard units must be carried prominently on the 'principle display panel' of the packages. The requirement must be met before import clearance from customs. The stipulations regarding labelling and marking requirements on traded/packaged goods are laid down in a number of central acts and rules. States also have their own regulations on labelling and marking requirements on traded/packaged goods. An amendment made in Section 17.3 of the Custom Tariff Act, 1975 relates to packaged commodities imported into India, which imposes additional duty on the basis of the good's maximum retail price in India, making the imported item very expensive.

The import of rough marble blocks and slabs is subject to licensing procedures, which are considered by an inter-ministerial facilitation committee comprising representatives from various ministries/departments. These licensing procedures are lengthy and cumbersome. This restricts the role of the individual importer.

Sensitive items can only be imported from 11 customs ports out of a total of 21,516 and 1 out of 51 inland container depots. Clothing accessories can only be imported from five specified ports and two inland container depots. Pakistani exports of items on the sensitive lists not only pay higher tariffs but also have to incur higher costs to divert cargo to designated ports.

Other industries where certification, licensing procedures or import quotas are provided in the following list:

- Powdered milk, maize, crude sunflower oils, and refined rape, colza and mustard oil are subject to tariff rate quotas (TRQs). These were introduced to permit small quotas to be imported over moderate tariffs, while applying high tariffs to imports in excess of the quota amounts.
- Tobacco products, motor spirit, polyester filament yarn, motor vehicles and two wheelers are subject to the national calamity duty (NCD).
- Indian State Trading Enterprises (STE) controls imports of rice, wheat, all coarse grains except maize and barley, and copra, including imports of important refined petroleum products.
- The Jute and Jute Textiles Control Order, 2000 stipulates that each imported jute bag must give the country of origin on the bag and DGFT code number of the importer. The requirement must be met before the import clearance at customs (Sohail 2010).

17.3.4 Pakistan–Sri Lanka trade relations

The Framework Agreement of Pakistan–Sri Lanka Free Trade Agreement (PSFTA) was signed in August 2002. The main objective of the Agreement is to promote closer economic integration between the two countries for the realisation of enhanced trade and investment opportunities for the mutual benefit of both countries. As a result of successful implementation, the positive trend is expected to continue in both directions with diversification of exports under the Agreement. The scope of the FTA would be expanded covering areas of services and investment co-operation. After conducting several rounds of bilateral negotiations, Pakistan and Sri Lanka signed a Protocol, which aims at moving towards a comprehensive economic partnership agreement, covering trade in services and investment co-operation.

The value of total trade between the two countries, which stood at US$97.72 million in 2001, has increased up to US$271 million in 2009. Items such as fresh pineapple, sports goods, tamarind seeds, coconut, edible oil and activated carbon have gained access to the Pakistani market. Pakistan has also granted duty-free access for Sri Lankan products like tea and betel leaves, albeit with quotas, coconut products, natural rubber, spices, natural graphite, paper boards and articles of aluminium. Major import items from Pakistan to Sri Lanka include cotton, dried fish, potatoes, rice, big-onions, fabrics, medicaments, textile fibres, electrical machines and apparatus, etc.

The PSFTA makes Pakistan the second largest trade partner for Sri Lanka in South Asia. Pakistan had granted 100 per cent immediate tariff concessions on 206 items

in 2002 while Sri Lanka granted immediate duty-free access to Pakistan for 102 products. Under the RoO, only products originating from Pakistan and Sri Lanka would benefit from the agreement, according to the Ceylon Chamber of Commerce. Other products that have some imported materials as inputs have to have 35 per cent value addition. Under cumulative rules of origin to meet the 35 per cent value-addition criteria, a producer can use raw material imported from either of the contracting parties up to the value of 10 per cent and the remaining 25 per cent to be met through value addition at home (Lanka Business Online 2009).

There is limited published research on the specific barriers to trade faced by Sri Lankan and Pakistani traders. The US 'National Trade Estimate Report on Foreign Trade Barriers 2009' has country studies of Sri Lanka and Pakistan's tariff structures and barriers to trade, more specifically with respect to the US trade potential. Currently, 102 items are subject to the Sri Lanka Standards Institution (SLSI) mandatory import inspection scheme. These include food, steel, electrical cables, switches, water heaters and cement. Importers of these items must obtain a clearance certificate from the SLSI to sell their goods. SLSI accepts letters of conformity from foreign laboratories, but retains the discretion to take samples and perform tests (United States Trade Representative 2009).

The bilateral agreement between Pakistan and Sri Lanka has addressed several of the issues relating to tariff and NTBs. There is a greater opportunity available under the BFTA as compared to SAFTA. However, slow dissemination of BFTA in Pakistan is one critical reason that has led to slow growth of trade and investment between the two countries.

17.4 Intra-industry trade in South Asia: Evidence and issues

The literature on trade normally talks about two types of intra-industry trade within economies, horizontal and vertical. Horizontal intra-industry trade normally comprises trade in different varieties of a particular good within the same production stage and in the same quality and price range. This usually occurs as a result of product differentiation and better quality brands that provide superior consumer choice and diversity in consumption. On the other hand, vertical intra-industry comprises trade between goods that are of different quality or goods that are part of a production value chain of a final good (product fragmentation). This chapter focuses on the second type of intra-industry trade that is vertical integration intra-industry trade. Gains from product fragmentation trade rely on how efficiently the product value chain can be sourced from different regions. A hypothetical example of such a value chain would be if a firm was to invest in a fan manufacturing plant in Pakistan, production of motors in Bangladesh, designing facilities in Sri Lanka and market it through India. This should be done ensuring that each stage of production would occur where it is most cost effective to do so, and the final product will be extremely competitive in the international market.

There is also evidence to suggest that South Asia has been slow to take off and take advantage of product differentiation in trade. Khan (2010) constructed the so-called Grubel–Lloyd Index, which gives the ratio of intra-industry trade to total trade. The

index value of 1 shows complete intra-industry trade, while a value of 0 depicts inter-industry trade (i.e. absence of any intra-industry trade).

The complete index values, as presented in Table 17.3, are extremely low, indicating very limited intra-industry trade, even at the SITC two-digit level (i.e. highest level of aggregation). The results also indicate that the highest level of intra-industry trade takes place in textile yarn, fabrics, made-up articles, etc., (Chapter 65).[8] In addition, the highest level of bilateral trade also takes place within textile yarn, fabrics, made-up articles, etc., (Chapter 65) category between Bangladesh and Pakistan (GL Index 0.02399). There is negligible intra-industry trade between India and Pakistan, while intra-industry trade between Pakistan and Sri Lanka is more prominent than intra-industry trade between Pakistan and Bangladesh. This is a result of the presence of the bilateral FTA between Pakistan and Sri Lanka. Therefore, South Asian co-operation under SAARC has not improved intra-industry trade within South Asia.

Critical reasons for this low level of intra-industry trade include:

(i) existing sourcing relations and end-buyer preferences already established outside of South Asia;

(ii) prices tend to be on the higher side within the region due to bureaucratic red tape, energy cost and reliability, transportation cost and availability (port efficiency is extremely low in South Asia and time taken to ship in the Indian sub-continent is substantially higher than that in other regions; shipping times have also increased due to differential duty levels and RoO criteria, and also due to a mismatch between regional and local regulations);

(iii) tariffs and NTBs;

(iv) gaps in infrastructure;

(v) complex political economy;

(vi) lack of supply capacity and product variety; and

(vii) limited intra-regional investment.[9]

17.5 Conclusion

This chapter has considered, from the perspective of Pakistan, broad areas impacting trade and integration potential in South Asia. It has discussed in detail the nature and impact of NTBs faced by Pakistan when trading with three major economies (India, Sri Lanka and Bangladesh) of South Asia. Integration is not going to work unless the complexities of trading within the region are eliminated. The respective governments of Pakistan and India will have to think more broadly in terms of regional integration (infrastructural constraints), regional competitiveness, compliance and certification issues, and will have to resolve the political ties without further delay. Political stability is the prime pre-condition for any type of integration measure to work successfully. On the economic front, the two governments intend to tackle a broad agenda, including improving trade logistics; easing visa restrictions; reducing NTBs; facilitating trade via the sea, land, and rail routes; and opening up the banking sectors.

Table 17.3 Weighted GL Index for industries at SITC two-digit level – South Asia (2008)

CODE		Pk-In	Pk-SL	Pk-Bn
5	**Chemicals and related products**			
51	Organic chemicals	0.0048	0.00245	0
52	Inorganic chemicals	0.0005	0.00172	0.00017
53	Dyeing, tanning and colouring materials	0	0.00017	0
54	Medicinal and pharmaceutical products	0.0001	0.00019	0.00017
55	Essential oils and resinoids, etc.	0.0001	0.00026	0
56	Fertilisers	0	0	0
57	Plastics in primary form	0.0004	0.00369	0.00018
58	Plastics in non-primary form	0.002	0	0
59	Chemical materials and products	0.0005	0.00094	0
6	**Manufactured goods classified chiefly by material**			
61	Leather and leather manufactures etc.	0.0009	0.00008	0.00078
62	Rubber manufactures	0	0.00004	0
63	Cork and wood manufactures (excluding furniture)	0	0.00023	0
64	Paper, paperboard and articles of paper pulp, of paper or of paperboard	0	0.00022	0.00002
65	Textile yarn, fabrics, made-up articles, etc.	0.008	0.01395	0.02399
66	Non-metallic mineral manufactures	0.005	0.00092	0.00004
67	Iron and steel	0.0003	0.00022	0.00002
68	Non-ferrous metals	0.0032	0.0001	0
69	Manufactures of metals etc.	0.0009	0.0002	0.00112
7	**Machinery and transport equipment**			
71	Power-generating machinery and equipment	0.0001	0	0.00063
72	Machinery specialised for particular industries	0.0012	0.0011	0.00082
73	Metalworking machinery	0	0	0
74	General industrial machinery and equipment, etc.	0.0006	0.00001	0.0001
75	Office machines and automatic data-processing machines	0	0.00012	0
76	Telecommunications and sound-recording	0	0.00012	0.00001
77	Electrical machinery	0.0005	0.00167	0.00041
78	Road vehicles	0	0.00007	
79	Other transport equipment	0		0
8	**Miscellaneous manufactured articles**			
81	Prefabricated buildings etc.	0	0	0
82	Furniture etc.	0	0.00006	0.00014
83	Travel goods, handbags, etc.	0		0.00001
84	Articles of apparel and clothing accessories	0	0.00208	0.00223
85	Footwear	0		0
87	Professional, scientific and controlling instruments and apparatus	0.0014	0	0
88	Photographic apparatus, equipment and supplies and optical goods, etc.	0	0	0
89	Miscellaneous manufactured articles etc.	0.0016	0.00618	0.00115

Source: Calculations are based on data from Khan (2010)

Moreover, the countries will have to rationalise NTBs by taking a sectoral approach. The nature of NTBs, especially those relating to quality and standards and technical requirements, can only be resolved if sector-specific issues are addressed. In some cases, simple recognition of country standards will result in immediate benefits, whilst in others a more detailed analysis, capacity building and better understanding may be required. Improvement in the flow of information will also help in reducing the impeding nature of the NTBs; for example, in the case of Bangladesh if all requirements are clearly stated on the internet on official government websites and the standards are defined it will be much easier for exporters to meet those standards. Rationalisation of negative lists and considering reducing the tariffs even below 5 per cent will also help in stimulating trade within the region.

While NTBs are inhibiting trade within the region, other costs incurred due to physical, logistical and bureaucratic barriers to trade are also extremely important. South Asia is often reported to encompass inadequate supply chains and trade facilitation is considered as a major impediment to trade integration in the South Asia.

There is limited evidence of intra-industry/product fragmentation trade within South Asia. The nature of product fragmentation trade is such that it is most viable in relatively high technology production sectors, such as electronics and automobiles. Hence, a pre-condition is that countries engaged in slicing up the value chain need to have the required human resources and skill sets. In South Asia, with the exception of India, the level of skilled human resources is extremely low. This asymmetry is restricting the technologically advanced economy of India from diverting some parts of its product value chain to countries in the region. Furthermore, transport bottlenecks both with and between countries are impacting inter-industry but more so intra-industry trade. South Asia is reported to suffer due to high delivery costs, large transit times and the reliability and predictability of delivery. Finally, all countries will have to work on improving their product lines and shift their focus towards producing goods that have growing market demands both regionally and internationally.

If integration is to succeed in the region, it is essential that the member countries make investments in improving the logistical infrastructure, improving connectivity and improving information flow, make cross-border investments (a framework for investment must follow SAFTA) and work on relaxing NTBs for partner countries. Intra-industry trade is one way of reducing NTBs, improving infrastructure and attracting investment is another. However, the evidence on causality is mixed in terms of differentiating between the causes and the outcomes. It is only by way of working with each other in partnerships that South Asia will be able to achieve its overall challenge of creating a better life for its citizens.

Notes

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2 Trade creation occurs when an economy is able to trade some parts of its production line with more cost-efficient production within the region due to favourable trade conditions created under the regional trade agreement. Trade diversion occurs when the asymmetric nature of trade barriers between intra-regional and extra-regional countries makes a country trade within the region rather than with economies outside the region that are more cost efficient.

3 For a discussion of the granting of MFN, see Khan (2011).

4 Both SAFTA and SAPTA are part of the South Asian Association for Regional Cooperation (SAARC), formed in 1985. The original SAARC members were Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka. Afghanistan joined SAARC in 2007.

5 By way of comparison, India and Sri Lanka have had a free trade agreement (FTA) since 2000, and total Indian–Sri Lankan trade is about US$4 billion, even though Sri Lanka's GDP is roughly a quarter that of Pakistan's. Also, Indian trade with Bangladesh, which is half the size of Pakistan's GDP, reached $3.5 billion in 2010.

6 Mr SN Rao (Indian Commerce Secretary) stated this at a conference organised by the Indian Council for Research on International Economic Relations (ICRIER), held on 14–15 March 2013 in New Delhi, India.

7 Meeting with Syed Yawar Ali, Vice President of the India–Pakistan Business Council, Lahore, 25 March 2013.

8 The indices show that the highest level of intra-industry trade within the region takes place in the textile yarn, fabrics, made-up articles and related products category (chapter 65). Although the numbers are not presented in this chapter, if one were to look at the trade relations between other members in South Asia, then the highest intensity of bilateral intra-industry trade takes place within textile yarn between Sri Lanka and Bangladesh – while Sri Lanka exports US$5,298,956 worth of textile yarn, fabric, made-up articles and related products to Bangladesh, it also imports goods worth US$4,564,944 of the same category from Bangladesh. Furthermore, it can also be seen that trade between Sri Lanka and India and India and Nepal have a higher propensity for intra-industry trade.

If one further disaggregates trade data at the SITC three-digit level in the textile sector, intra-industry trade is observed to be relatively higher among countries in the region. There is relatively high intra-industry trade in the 'textile yarn' sector with the highest bilateral trade flows in this sector taking place between Sri Lanka and Bangladesh. Apart from Sri Lanka and Bangladesh, there is also intra-industry trade to a notable extent between India and Pakistan and India and Nepal.

9 The largest South Asian investment in the region has been by Brandix, a large Sri Lankan apparel exporter – the 1000-acre park which was set up in India in 2005 with an investment of US$750 million expected to rise to US$3 billion.

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