Consultative Meeting on Trade Normalization and FDI Prospects for India & Pakistan

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Concept Note

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Contents

Pakistan's FDI Prospects in India: Concerns & Opportunities

The recent announcement by Indian Government regarding opening up of country's foreign direct Investment (FDI) regime for Pakistani investors comes at a time when India-Pakistan trade normalization process is progressing at an encouraging pace and deeper economic integration between two largest SAARC member countries is need of the hour.

It is no surprise that investors of both countries have been working closely in joint ventures in countries abroad but could not progress on their home ground due to political barriers. However there were some who managed to bypass such barriers and more recently Pakistani businessmen based and registered in places like Dubai and Malaysia had started investing in India through partnership agreements with Indian resident businessmen.

There also exists readiness of investors on both sides to employ their competitive advantages in their neighborhood and reaping economies of scale. The examples of India's Tata group showing interest in Pakistan's energy sector (particularly Thar Coal) and Pakistan's Mansha group showing interest in India's banking sector (particularly consumer banking) shows that on both sides the business community has done comprehensive home work towards exploring their niche.

The academia and development partners have long demonstrated through empirical methods how supply chain development in South Asian countries can benefit the region as a whole. Sadly not much research exists at sectoral level specifically for India and Pakistan. However the recent experience of Pakistani investors in Bangladesh proves the win-win case for both countries.

Around 2008 several Pakistani textile firms opened up their branches in Bangladesh in order to reap the benefits of Bangladesh's LDC status which allows the country duty free access or reduced tariffs in foreign markets particularly EU and US where major market exists for Pakistan's readymade garments. The 2010 data on such Pakistani firms showed employment creation for Bangladesh's labor force, technology transfer for Bangladesh's textile sector, increased royalty for Pakistani investors, and increased exports of Pakistani textile sector raw material (such as dyes, chemicals and threads) to Bangladesh. Similar story has been observed in case of Pakistan's investments in Sri Lanka (both countries have signed bilateral investment treaty) in sectors such as food processing and construction materials.

Replicating the regional experiences for India-Pakistan should not be difficult given the sheer size of both economies and the opportunity presented by a large and growing domestic demand in both countries. While Pakistan is soon expected to reciprocate India's decision of opening up FDI, several complimentary reforms may also be required in order to ensure smooth flow of investments between the two countries.

First the home departments on both sides should ensure that the recently agreed liberalization of visa policy between the two countries is fully implemented and expanded to other cities on expedient basis. Allowing physical capital to move while human capital is curtailed does more harm to the production process and prevents future cash flows. This happened last year when Pakistan's government drastically reduced the sensitive list and liberalized trade with India. While Steel manufacturers in Pakistan could now import machinery at much reduced rates from India in comparison to other parts of the world, however such machinery was lying redundant for weeks and sometime months due to the delays in allowing visas for Indian engineers who were to come to Pakistan for installation of machinery.

Second there is a need to harmonize product standards with rest of the world. In our discussion with for example the auto part manufacturers of Pakistan, we were informed that while they were interested in investing in this sector in India however the two standards in this industry followed by India (Bharat 1 and Bharat 2) are seen in no other country in the world. Such standards act as barriers to entry for producers who can genuinely enhance consumer surplus in India. The consumer rights organizations in both countries should take note of such standards that curtail trade and investment thereby leading to ultimate decrease in consumer welfare.

Third a natural path in economic integration for both countries should be to move towards a bilateral investment treaty. The business community on both sides will feel much safer and confident in operating if their investments have such a cover. Under such a treaty the investment from the other country is treated as favorable as the host country treats its own investors. Similarly country-specific biases in competition policy and other sector-specific policies are removed. Such treaties also allow transfer of investment-related funds into and out of a host country without any delay and as per exchange rate observed in the open market.

Fourth and a point related with the above is the need for *sovereign guarantees framework* – at least for the short term. If both countries are serious in hosting each other's investments, then such physical and financial capital migration must be protected from political upheavals. Most of the investors we have come across in Pakistan were fearful if any future political frictions between the two countries end up affecting their business in India. This points towards the short term need for providing sovereign guarantee to an investor from Pakistan (and vice versa) that in the event of any harm caused to his or her investment in India due to actions related to foreign or defense policy actions will be fully compensated. It is important to note that such a measure will not be required if both countries move towards a comprehensive bilateral investment treaty.

In view of the above mentioned observations this consultative session aims to focus on the following issues:

1. Willingness of Pakistani investors towards investment opportunities in India?
2. What are the key sectors available to Pakistani investors in India?
3. How well the key sectors offered by India compare with potential of Pakistani Investors?

4. What are the general barriers regarding investment particularly at sub-national level?
5. Are there any Pakistan-specific barriers regarding investment in India?
6. How well does the opening up of FDI in India facilitate Pakistan's services sector?
7. What are the prospects of legal and constitutional cover to Pakistani investors in the event of a political upheaval?
8. How will the decision of allowing Pakistani investors to invest in India strengthen bilateral relations and also help in solving the longstanding political disputes?
9. What is the dispute resolution mechanism for Pakistani Investors in India?
10. What is the level of cooperation between government investment bodies in India and Pakistan?
11. How will the recently liberalized trade between India and Pakistan help improve FDI prospects?

Pakistan- India Trade Normalization: Importers & Exporters Perspective

Recently, Pakistan and India have been successful in negotiating what some may call a new era in India Pakistan economic relations. Both countries have slashed their sensitive lists. Some have also gone as far as to recommend a bilateral free trade agreement between the two countries, since progress on the already signed South Asian Free Trade Agreement (SAFTA) has been slow. While during the past few months, a lot of steps (particularly customs related) have been taken by both sides to increase bilateral trade, the issue of non-trade barriers remains a major obstacle in normalizing trade relations between the two countries. This consultative meeting is envisaged to highlight the gains and losses which are sector-specific and also bifurcated from the perspective of importers and exporters.

Demand-side Analysis: Importers' Perspective

The business community has already expressed their thoughts on how liberalized trade with India will in turn result in acquisition of raw material and related intermediate goods at much lower prices, in turn increasing the producer's surplus. However in the entire discourse consumers have been the silent audience. Through engaging with the importers of Indian goods we hope to strengthen the constituency for consumers who are undoubtedly going to gain in various respects through a liberalized India Pakistan trade. Alongside the key importing entities we have also invited for this meeting important consumer groups from Sindh province.

Non-Tariff Barriers in India: Exporters' Perspective

In the past several decades while track-II work (led by civil society think tanks) was going on, track-1 remained dormant in issues such as economic and trade integration in South Asia. This remained so even until late 2010. However after the mid of 2011 with the increased interaction between Ministries of Commerce on both sides and President Asif Ali Zardari's visit to India, track-I seems to have become very active and gathering momentum with each passing day and somehow track-II is falling behind. Through this consultative session SDPI aims to investigate how best track-I and track-II should complement each other in a more effective manner. One of the avenues where such opportunity exists is the current prevalence of non-tariff barriers (NTBs) due to which potential benefits of SAFTA have been compromised in the past. Some of the key objectives of our proposed discussion include:

- Identify and update the NTBs (particularly in non-traditional export items) facing agriculture, intermediate and finished goods in India and Pakistan
- Quantify the impact of NTBs in selected sectors on producers in India and Pakistan
- Simulate possible impacts of relaxations in NTBs (e.g. logistics-related) on producers and consumers in India and Pakistan
- Provide policy relevant advice on how NTBs in the selected sectors can be removed, phased out or replaced with less distortionary forms of barriers

Expected Outputs from the Meeting

SDPI as one of the oldest think tanks in Pakistan has a history of working towards closer South Asian collaboration in economic spheres. Since the last 20 years, it has been serving as an informed and independent voice in policy debates; identifying, articulating and evaluating current policy issues, proposals and programs. The impact that SDPI has had over the formulation of various policies over the years has been possible largely due to the construction of 'action networks', members of which belong to international academia, business community, media and parliamentarians. Information dissemination through a strong network of specialists and policy formulators has not only ensured that SDPI's output is always heard, but also that this voice has a considerable impact on policy formulation.

SDPI plans on using these networks to spread its research and recommendations on bilateral trade relations between India and Pakistan, which would without doubt prove to be seminal in the new and changing dynamics of relations between these two countries. The recommendations and opinions of various stakeholder groups need to be identified and analyzed in order to provide future policy recommendations on the various facets India Pakistan economic cooperation. This without doubt, is the core objective of this consultative meeting. The consultative meeting is planned to end with a presentation of the recommendations originating from each panel discussion held on the day. These recommendations on the issues of FDI in India and NTBs in both countries will then be compiled into separate report briefs as well as documentaries at Sustainable Development Television. Some key recipients of the outputs and recommendations (on the government side) include:

- The Honorable Prime Minister of Pakistan, Raja Pervez Ashraf
- Federal Minister for Finance, Dr. Abdul Hafeez Sheikh
- Federal Minister for Foreign Affairs, Hina Rabbani Khar
- Deputy Chairman, Planning Commission, Dr. Nadeem Ul Haque
- Cabinet Members
- Secretary, Ministry of Commerce
- Secretary, Ministry of Finance
- Secretary, Ministry of Interior
- Secretary, Ministry of Foreign Affairs
- Secretary, Ministry of Textile Industry
- Secretary, Ministry of Ports and Shipping
- Chairman, Trade and Development Authority of Pakistan (TDAP)
- Standing Parliamentarian Committees on Trade and Commerce
- Chairman, Federal Board of Revenue
- SAARC Chamber of Commerce and Industry
- Indian High Commissioner in Pakistan

Since trade between India and Pakistan has positive implications not only for both countries but for the South Asian region as a whole, SDPI plans on engaging government officials and policy advisors from other South Asian countries through various avenues. Currently, SDPI is involved with many other South Asian think tanks on research and advocacy in trade and sustainable development. Some of these think tanks include:

- Consumer Unity and Trust Society (CUTS), India
- Research and Information System for Developing Countries (RIS), India
- Indian Council for Research and International Economic Relations (ICRIER)
- South Asian Network for Development and Environmental Economics (SANDEE)
- South Asia Watch on Trade, Economics and Environment (SAWTEE)
- Centre for Policy Dialogue (CPD), Bangladesh
- South Asia Centre for Policy Studies (SACEPS)
- Institute for Policy Studies (IPS), Sri Lanka

Using the informed discussion during this consultative meeting, SDPI will continue to keep the debate alive through social media. The post-consultation debate will be moderated over facebook and Linkedin and latter compiled in the form of a whitepaper.

Furthermore the research outputs and recommendations of this consultative meeting will be disseminated in the form of penal-wise published reports, newspaper Op-Eds, and seminars at the Press Club.

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