On the Effectiveness of Granting the Most Favored Nation Status to India

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Pakistan and India, having a prior history of political tensions and conflicts, have decided to embark on the journey of negotiations on bilateral trade vis-à-vis a Most Favored Nation (MFN) relationship. The recent debate on the normalization of trade ties between Pakistan and India has been an on-going discussion about how Pakistan decided to reciprocate the MFN status to India. The Pakistani media, especially the print media, has been viewing this discussion with a critical eye by questioning the *effectiveness* of granting MFN status to India. This paper aims to focus on evaluating the efficacy of awarding MFN status to India in the light of proposed reduction in informal trade between India and Pakistan and a pervasive restrictive trade regime adopted by India. Despite of the fact that Pakistan would have eventually granted MFN status to all member countries of World Trade Organization (WTO), the decision to grant the status to India will show to be ineffective in the presence of non-tariff barriers (NTBs) adopted by India, preventing any significant shift of informal trade to legal channels under the MFN regime.

Both Pakistan and India are of the founding signatories to the GATT (General Agreement on Tariffs and Trade), signed in 1948 and later replaced by WTO in 1995. As part of this agreement, the MFN treatment clause had been inserted according to which the member WTO countries "shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than that it accords to like services and service suppliers of any other country" (Article 1 of the General Agreement on Trade in Services).[1] Thus, in the context of Pakistan, granting MFN status to India does not imply any special treatment as a trading partner. It rather suggests non-discrimination towards India, by treating it on par with the other 100 member countries that have been granted the MFN status by Pakistan.

Trade Relations between Pakistan and India

The amount of official trade between Pakistan and India remains negligible, as compared to their respective global trade volume, and neither of the two countries falls in the category of "top ten trading partners" [2] of each other. Perhaps, Pakistan and India are the only two large neighbours that have extremely restricted trade relations. It is believed that granting India the MFN status would increase in bilateral trade between the two countries, as it would imply opening up the two economies. However, any decision pertaining to trade between the two countries must be done in a manner that benefits both trading partners on equal footage, rather than being skewed in favor of one partner.

Pakistan was given the MFN status by India in 1996, while "Pakistan continued to allow imports based on its Import Trade Order/Import Policy/Positive List." [3] However, despite being granted the MFN status, the trade figures have not been in favor of Pakistan. In 1995-1996, Pakistan exported US $41 million and imported US $92 million worth of goods from India. The trade gap amounted to US $52 million, in favor of India as opposed to Pakistan.[4] This gap has been growing ever since the grant of MFN status to Pakistan. The trade ratio between the two countries was approximately 1:2 in 1996; however, in 2010-2011 this ratio showed to be 1:6, despite the fact that Pakistan had still not officially granted the MFN status to India. The gesture of MFN status to Pakistan by India should have been favorable for Pakistan. Nonetheless, “the gesture did not help Pakistan in any way, because it was followed by the imposition of a number of *non-tariff barriers* by the Indian side, which ironically further crippled the access of the Pakistani products to the Indian market.”[5]

Non-tariff Barriers (NTBs)

The presence of non-tariff barriers (NTBs) plays a major role in assessing the effectiveness of Pakistan’s decision to grant the MFN status to India. A non-tariff barrier is a form of trade barrier “where a country imposes restrictions such as unreasonably high regulatory standards or lists of permissible items which constrict the free flow of trade between two nations.”[6] India is known to have one of the most restrictive import regimes in the world in terms of “safeguard measures for its benefits.” [7] A WTO report has recently reported that: “India was one of the highest users of anti-dumping and frequent user of safeguard measures against imports from other countries.”[8] India’s position in the World Bank’s Trade Tariff Restrictiveness Index (TTRI) is 115th out of 125 countries, while Pakistan is ranked as being in the 102nd place. Moreover, India’s rankings on the ‘Ease of Doing Business’ indicators are also low with a ranking off 122 out of 178 countries, compared to Pakistan’s rank at 77th place, for 2006-2008.[9] In the presence of such a restrictive Indian trade regime, Pakistani exports have been unable to make headway in the Indian markets, despite the fact that it has been 16 years since Pakistan was granted the MFN status by India. Even though Pakistan has reciprocated the MFN status to India, without a significant reduction in NTBs adopted by India, it will not reap substantial benefits for Pakistani producers, thus rendering the MFN status for India as not only ineffective, but also undesirable for Pakistan.

Different NTBs and their effect

The various NTBs faced by Pakistani exporters, include labeling and marking rules, packaging rules specification, stringent custom documentation, restrains the free flow of goods, import licenses, especially for vehicles and motorcycles, obligatory standards under the Bureau of India Standards (BIS), whereby BIS license has to be acquired (which includes application fees), expenses of inspection visits from India to foreign countries, and processing charges, to name a few. In his article titled ‘Revisiting MFN status’[10], Shakib Shirani highlighted a specific example showing the restrictiveness of India’s trade regime. Export samples are sent to ‘any number’ of testing laboratories in India, while Pakistani exporters await the results for an unspecified and uncertain amount of time. The presence of such NTBs has been a major obstacle for Pakistani businessmen and industrialists in trading with their Indian counterparts. Until India decides to reduce these NTBs, the granting of the MFN status to India will not have done anything to benefit Pakistani traders and exporters. Merely reciprocating the MFN status to India, without significant reduction in NTBs from India’s side, will result in further trade deficit for Pakistan. India will benefit by flooding the Pakistani markets with Indian goods, while Pakistanis would not even be able to gain easy access to Indian market due to Indian routine bureaucratic red tape in the form of NTBs. Therefore, for the MFN status to be effective for both Pakistan and India, India must reduce its non-tariff barriers so that “both the sides have a level playing field to do business with each other,” [11] according to Pakistan’s Federal Secretary of Commerce, Zafar Mehmood.

Informal Trade

The presence of high NTBs has given rise to informal trade between Pakistan and India.[12] Apart from the presence of NTBs, it is believed that high transaction costs for passing the goods through formal channels has also increased informal trade between the two countries. It is possible that granting the MFN status to India will now compel most of the trade to take place through formal channels. The informal trade between Pakistan and India takes two forms. The first takes the form of *smuggling*, which is “illegal trade through borders between the two countries.”[13] According to The Sustainable Development Policy Institute (SDPI), this unofficial trade takes place through the Amritsar-Wagah route in the north and the Mumbai-Karachi route through boats. The other type of informal trade takes place through *circuitous routes*. Containerized trade takes place through these routes, where goods from country A are shipped to a country B. The documentation on the origin of these goods is altered, and then they are further shipped to the destination country C.[14] Some of the circular routes are Mumbai-Kabul-Bara, India-Dubai-Karachi, India-Singapore-Karachi, and India-Hong Kong-Karachi. Much of the informal trade takes place with goods that are not on the positive list for Pakistan and which have a high demand in either country. Much of this type of trade takes place for cloth, mostly silk, followed by pharmaceuticals, textile machinery, tyres, cosmetics and jewelry.

Amount of Informal Trade

Various attempts have been made to quantify the amount of informal trade between the two countries. It is believed that the informal trade with India lies between US $0.5 billion to US $10 billion; however "a more realistic figure appears to be US $2-3 billion".[15] One of the findings of The Sustainable Policy and Development Institute's chapter, "Quantifying Informal Trade Between Pakistan and India," is that unofficial trade between Pakistan and India has been around $545 million in 2005. The result is based on field research in Dubai, border regions and major urban markets. [16] This study casts some serious doubts on the validity of earlier studies that have attempted to quantify the informal trade with India. This study highlights that the amount of informal trade is much lower than the previous "guesstimates" of informal trade with India. The study concludes that giving MFN status to India is not a "sufficient condition for affecting a substantive change" and *"80 percent of the informal trade is likely to continue even if Pakistan were to grant MFN status to India."* This renders the initial proposition that granting MFN status to India would help reduce informal trade with India invalid. Merely granting the MFN status to India may not be very *effective* in reducing the amount of informal trade between the two countries. Reduction in high transaction costs, along with decreasing in procedural impediments and a move towards SAFTA (South Asian Free Trade Area), may prove to be more effective ways for diverting informal trade to formal channels of trading.

Conclusion

Reinforcing the argument of effectiveness regarding the granting of the MFN status to India, it is believed that the decision to grant the status will lead to benefits for Pakistan only when India agrees to take up a less restrictive trade regime. As of now, this has been proving to be a major hindrance for Pakistani exporters in accessing the Indian markets. Pakistan should reassess its granting of MFN status and gage how to encourage significant steps to being taken by India to reduce its non-tariff barriers. Furthermore, research shows that informal trade, arising mainly due to the presence of NTBs, may not undergo a significant reduction in an MFN regime. A move towards free trade through SAFTA may reduce the amount of unofficial trade between the two countries, but it should not take place on the expense of loss incurred by local industries of Pakistan.

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[14] Ibid

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