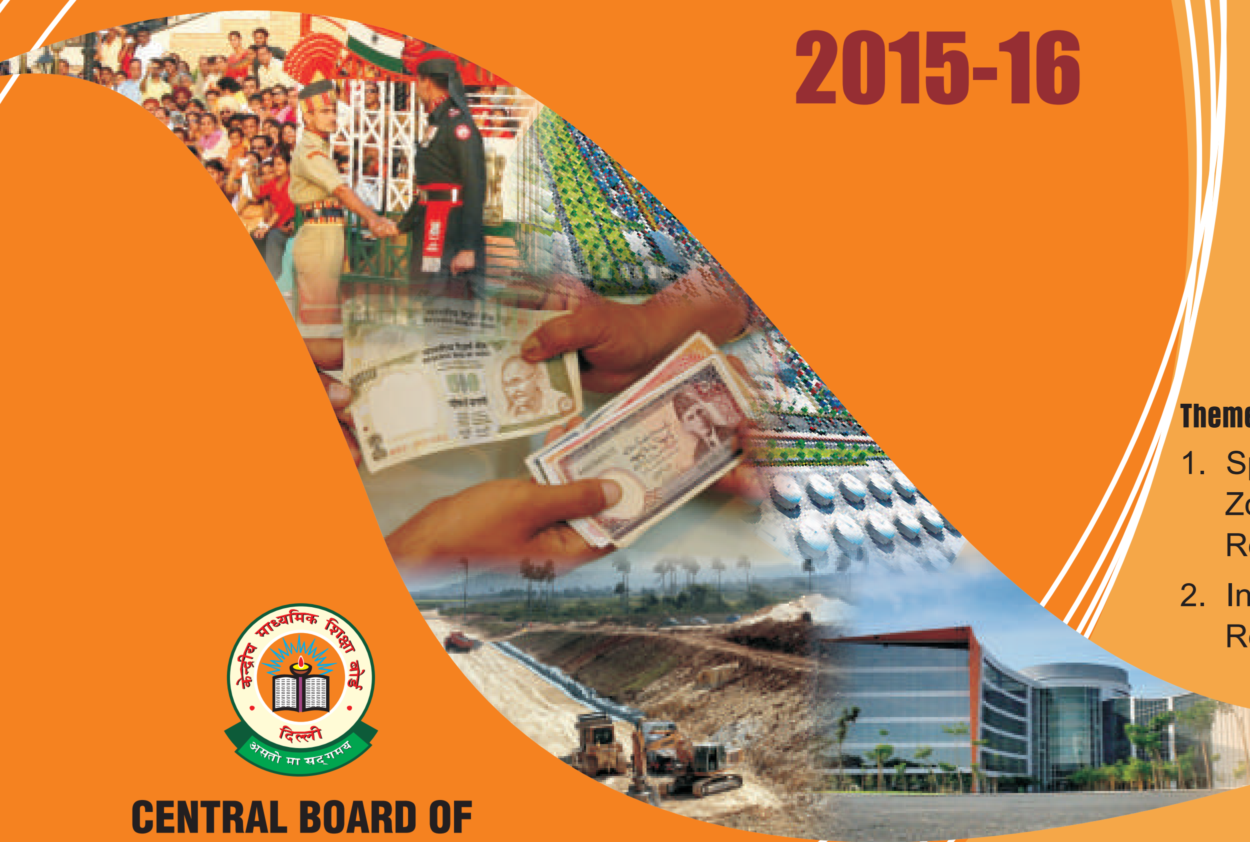
Economics

Class-XI

OPEN TEXT-BASED ASSESSMENT

2015-16



CENTRAL BOARD OF SECONDARY EDUCATION

Shiksha Kendra, 2, Community Centre,
Preet Vihar, Delhi-110301, India

OPEN TEXT–BASED ASSESSMENT

ECONOMICS CLASS-XI

Theme–1: Special Economic Zones (SEZ) – Route to Growth

Abstract

People across the world wonder about the phenomenal growth which the Chinese Economy has achieved over the last six decades. This rate of growth in manufacturing sector achieved by China was unheard of by economists. There have been a plethora of reasons which may be attributed towards remarkable growth process. However, the most undisputed of these can be termed as – SPECIAL ECONOMIC ZONES (SEZ) policy of China, which is not just very well articulated, but also rather is brilliantly executed as well. There is no denial to the fact that SEZ policy in China owes its success to various supporting and structural mechanisms which have been instrumental in making it a success.

However, not too many people are aware of the fact that Asia's first of its own kind of Economic Processing Zone(EPZ) was set up by India at Kandla (Gujrat) in the year 1965, which is an evidence of the fact that the Indian Economy initiated the process of growth on a positive note but faltered on the road ahead. SEZ policy in India was targeted to boost up the Indian Economy and the comparison on account of implementation with neighbouring countries will help us in better implementation of SEZ policies. This is a valid well-accepted fact that SEZ's can work wonders for an economy if properly planned and put into operation.

The following story-line is an attempt to understand this relatively complicated issue of SEZ policy as adopted by China and India from a student's perspective.

Scene I – An Economics teacher was discussing the background of the next project, in the form of a class presentation, to be given to the Class XI students from various topics of contemporary importance and relevant to the understanding of the students. He instructed the students to form groups of three students each so that he can assign the project. To a group of three friends (all very bright ones in the class) Bhavi, Anshita, and Rudrakshi he assigned the topic "SEZ policy of Peoples Republic of China and India and its contribution/role in the growth of these economies".

The three friends were shocked and started whispering, 'No, not China and its SEZ…, where are we going to get authentic data for China……. we would not be able to make a good project……… our class-mates will score more than us…….. let's request sir to change it…….. give us some other topic……….. let's go……..

"Any problems", the teacher asked?

Sir, yes …………..no……..please………

Teacher	:	What's the matter? Tell me clearly the issue which is bothering you people?
Bhavi	:	Sir, SEZ policy of China is a very vast topic and is beyond our reach. We will not be able to make a nice project.
Teacher	:	Who said that you will not be able to make a nice project?
Rudrakshi	:	Sir, this is the most difficult of the topics you have assigned to students in our class and we are afraid that hardly any authentic information would be available on this, that's why we are a little uncomfortable with this topic.
Teacher	:	Calm down, calm down! The reason for assigning you this topic is that only you three have the most inquisitive mind in the class and you all can do this project sincerely and honestly. Above all, the knowledge that you will gain would be immense. I have no doubt in the fact that the class would gain a lot from your research. I know you will not let me down.
Bhavi	:	OK Sir, we will try to live upto your expectations. Thanks.

Scene II – Lunch Break – The three friends went to the computer lab and explored the topic. They decided to divide the content to be developed amongst them. They had only a weekend to gather the information and then they had to work for the class presentation.

Scene III – Class Room on the next day.

The teacher announced, "It is now the turn of Bhavi, Anshita and Rudrakshi to make presentation to the class. Be Attentive."

Bhavi took the lead and started speaking about the historical aspect of SEZ policy of China.

Bhavi - Friends as you all know that the legendry leader Mao Zedong is known as the father of modern People's Republic of China, however it was Deng Xiaoping to whom one may credit the onus to **'Open Up'** the closed economy of China. He began the movement to liberalise the external sector of the economy of China in 1978. Some of the economists call it 'a venture to fit Capitalism into the Socialistic framework' while others call it a **'one-way-road for the external sector'**. The most important step taken in this direction was setting up of 'Special Economic Zones' by China.

Before moving further let us understand what does a Special Economic Zone (SEZ) mean?

SEZ is generally defined as designated areas/enclaves/zones specially kept for the manufacturers (foreign/domestic) to encourage manufacturing for exports. Such zones are characterized by more liberal laws and economic policies than the rest of the nation.

Who can Operate in a Special Economic Zone

- ANY MULTINATIONAL CORPORATION
- ANY DOMESTIC COMPANY
- GOVERNMENT OF THE COUNTRY
- JOINTLY BY ANY OF THE ABOVE

From 1979, China had gradually started creating SEZs, with property rights protection, tax breaks and a preferential land policy specifically for foreign investors. This SEZ experiment has transformed China into one of the largest FDI recipients, exporters and foreign ex-change reserve holders in the world.

In the early period of 1978, Chinese authorities adopted a prudent and balanced approach of not opening up the entire economy at one go rather to use the segmented approach to 'open up'. In the first phase, they chose four coastal cities for the purpose of SEZs which initially were lagged far behind in terms of economic strength and industrial development set up, one each at Shenzhen, Zuhai, Shantou (in Guangdong Province) and Xiamen (in Fujian Province). Later on, motivated by the successful experiment and experience of the initial four SEZs, various types of developmental zones were initiated in the other coastal regions of the country as well. In 1984, targeting growth in the un-developed coastal areas, 14 new regions were opened up for foreign trade and investment.

These were:

Dalian	Qinhuangdao	Tianjin	Yantai	Qingdao	Lianyungang	Nantong
Shanghai	Ningbo	Wenzhou	Fuzhou	Guangzhou	Zhanjiang	Beihai

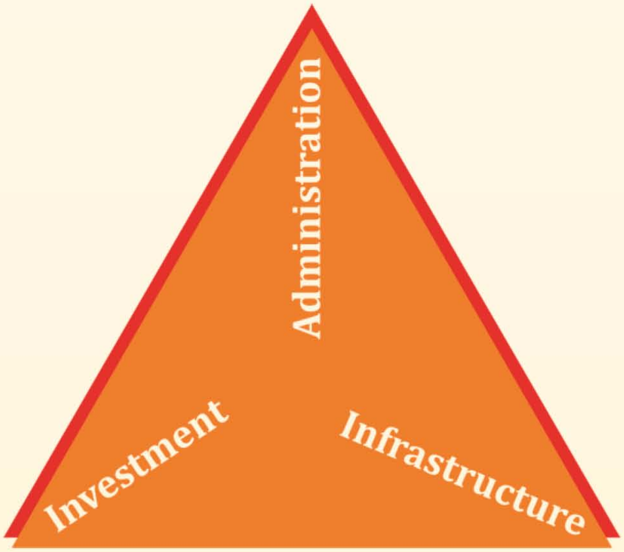
The objectives of such establishments in large and medium-sized cities were to attract technology-intensive and export-oriented industries/MNC's. The Chinese government experimented with different types of reform measures to liberate the external sector of the economy by taking into account the geographic advantages and development prospects of the region. Geographically all these types of development zones were located close to the coastal regions of south and southeast China to provide port facilities and expand trade activities.

Notably, *these regions were given special facilities and liberal incentives. In contrast, at that time, other parts of China were still under the rigid control of the Chinese central planning system. This policy of the Chinese authorities represented* ***the principle of 'Dual Policy – one country two policies'****.*

These enclaves acted as the prime growth engines of the economic transformation of China in the post-reform period and, subsequently, gained worldwide attention and emulation.

Now, I would like to invite my friend Anshita to carry on with the discussion regarding how China tackled with various **Supply Side Factors** to take the economy to greater heights.

Anshita – Hello friends, by now Bhavi has given us some excellent information on Special Economic Zone Policy of China, however, no economic growth model can work with only one factor, similarly **Chinese model of 'Opening Up'** concentrated on maintaining the growth momentum from both **supply as well as the demand side.** One advantage which China always had was the population for huge domestic demand prospects within the economy. However, like all other under-developed or developing countries, China too lacked the balancing force on the supply front. Chinese policy makers targeted a triangular policy initiative so as to make SEZ model concrete and successful. The three angles of this triangle are:



Let's understand them in details, one by one.

1. **Alteration in the Administration Arrangements -** The SEZ policy has brought the **'dawn of decentralization'** in the Chinese economy, which even today is providing its **'sunshine'** to it. SEZ's were supposed to work directly under the local authorities, which were given/entrusted upon vast administrative powers (such as formulation of development plans, approval of investment projects, insurance, banking, customs etc.). This called for major institutional reforms so as to open new avenues of growth, such reforms later proved to be the prime engines of growth for the Chinese Economic Structure. China, as a result, **simplified the stringent administrative procedures** of the pre-reforms era where the economic decisions were taken through the centralized planning; this according to economists had adversely hit the speed and efficiency of various developmental projects undertaken earlier.

2. **Inducement to Invest –** China successfully marketed the SEZ policy through various **fiscal and non-fiscal incentive schemes such as tax concessions, single window clearance of the projects etc. These steps were devised so as to attract the foreign investors to invest in the Chinese Economy.** Not just this, a fair degree of flexibility was adopted in such schemes. For instance, the corporate income tax rate at 15 % was much lower than the 30% imposed on domestic enterprises. In addition, the foreign enterprises were exempted from the 3% local income tax. The intentions were to motivate and attract foreign investment rather than to allow reallocation of domestic resources from one region to another. **Another striking point worth mentioning here is that in spite of huge incentive based structure being available, the SEZs in China did not result in revenue loss to the government exchequer. On the contrary, implementation of the SEZ policy, as expected, contributed to government revenue rather than creating adverse fiscal situations.**

   And my dear friends last but not the least, the most important of all…………

3. **Implausible Infrastructure –** it is a fundamental truth that no growth oriented scheme can ever be successful without proper infrastructural provisions to support the overall transition of the economy to the next level. In the process of developing infrastructure and attracting foreign investors in SEZs, the Chinese followed the proverb **'Build a nest first; birds will follow'**. Chinese policy makers not only understood the need for promoting infrastructure facilities in each of such zone but also paid attention in creating infrastructure in the country.

Fig: Results of SEZ Policy in China

I, thus, would like to conclude by saying that, SEZ policy played a vital role in transforming the traditional Chinese economy into a modern one. However, this would not have been possible without the following factors:

- Divorce from the existing rigid economic system followed during the pre-reform period.
- Subsequent reform measures provided main thrust for the success of reforms in China.
- Recognizing the loopholes in the economy and taking steps in the direction of removing them.
- Sincere initiatives at different levels of government.
- Decentralisation of authority to boost the efficiency of the administration and
- Instillation of reforms process at a time when, it hardly had any competitors in East Asia.

The above descriptive analysis clearly indicates that the decision to promote SEZs only constitutes the first step. The success of SEZs, however, was dependent on identification and removal of the factors hindering economic growth in the country. Besides, it also seeks effective integration and co-ordination of different conducive policies on the domestic and external fronts. To be precise, any policy cannot be expected to work under *ceteris paribus* conditions; rather it requires careful identification and execution of supportive factors, which may vary from country to country and sectors to sectors within a given economy.

With this I would like to hand over the mike to Rudrakshi, to elaborate further the detailed story of SEZ's in India from the beginning.

Rudrakshi - Thanks Anshita. Hi friends, we have discussed enough about the success story of our neighbour China on the SEZ front. While we were gathering information about the Chinese SEZ's, We came across with an astonishing fact that it was our own country India, which was a pioneer of SEZ's concept in Asia for the first time at Kandla (Gujrat) in the year 1965, although we called it as Economic Processing Zone (EPZ). However, we couldn't get the right track and momentum required to make it (EPZ/SEZ) a key factor in our growth strategy over a long period of time.

In my presentation, I will concentrate on the development of SEZ's in India over a period of time and will try to find the reasons behind the faltered growth of this policy in our country. Starting from 1965, India has established 8 fully developed EPZ's/SEZ's which are:

Kandla (Gujarat)	1965 (625 Acres)
Seepz (Maharashtra)	1975 (110 Acres)

Noida (U.P.)	1986 (310 Acres)
Madras (T.N.)	1986 (262 Acres)
Cochin (Kerala)	1986 (103 Acres)
Falta (W.B.)	1986 (280 Acres)
Visakhapatnam (A.P.)	1994 (360 Acres)
Surat (Gujrat)	1998 (103 Acres)

All of these EPZ's/SEZ's are contributing actively in the direction of export promotion and FDI (foreign direct investment) targets of the country. The government of India has given approvals for a large number of SEZ projects in the last few years since the implementation of SEZ Act, 2005. Keeping in view, the aim of attracting larger foreign capital and overcome. The past **shortcomings on account of multiplicity of controls, restrictions, licenses and clearances; the deficiency of world class infrastructure, and an unsteady fiscal regime in India.** The new Special Economic Zones (SEZs) Policy in its present form was announced in April 2006 under the SEZ Act, 2005 passed by the Parliament, with following aims.

Simplified Procedures

Single Window Clearances

Self Certification

- **Simplified procedures** for development, operation, maintenance of the Special Economic Zones and for setting up of units and conducting business in SEZs;
- **Single window clearance** for setting up of an SEZ and also for setting up a business unit in a Special Economic Zone.
- Simplified compliance procedures and documentation with an emphasis on **self certification.**

The main objectives of the SEZ Act, 2005 are:

- Generation of additional economic activity so as to achieve the target of higher GDP and economic development.
- Promotion of exports of goods and services to ensure greater foreign currency inflows. This is of utmost importance in a net importer country like ours.
- Promotion of investment from domestic sources to achieve higher savings and investment rate in the economy. This will also ensure augmented business activities in the country.
- Promotion of investment from foreign sources to ensure greater foreign direct investment in the country.
- Creation of employment opportunities.
- Development of infrastructure facilities carries an essential 'cause and effect' relation with the SEZ policy. Upgraded infrastructure is a pre-condition as well as a result of FDI to come into a country. It also ensures greater capital formation in any economy.

To ensure the achievement of the above stated objectives the SEZ Act, 2005 has laid down a variety of **incentives and facilities for attracting investments into the SEZs, including foreign investment initiatives.** To quote a few, most important ones are:

- Duty free import/domestic procurement of goods for development, operation and maintenance of SEZ units. This will ensure better quality of raw material availability in the economy, both the imported ones and the domestically produced.
- 100% Income Tax exemption on export income for SEZ units under Section 10AA of the Income Tax Act for first 5 years, 50% for next 5 years thereafter and 50% of the ploughed back export profit for next 5 years. Such kind of exemptions create a direct interest of the MNCs as well as the domestic companies to put their funds into the SEZ setups.
- Exemption from Central Sales Tax and from Service Tax. Both these taxes constitute a major portion of selling cost for the producers, any such exemption will be able to push the product in the domestic/export markets. Due to lower cost, the international competitiveness of the product will escalate and the producers will be able to register greater presence and profits in the market, both domestically and internationally.
- To ensure better **EASE OF DOING BUSINESS** the government has applied 'Single Window Clearance' for various Central and State level approvals, this will bring in larger number of foreign investors and also motivate the domestic companies.

These steps may be looked upon as the most essential confidence building measures in the direction of development of the SEZ's in India.

By this time, no student could see any fatigue on the face or in the body language of Rudrakshi, who has been elaborating the concept really well. She restarted after sipping water from her water-bottle.

Friends, now I would like to show some quantitative growth in exports from the operational SEZs in our country since the implementation of the new SEZ Act, 2005. **There has been a consistent rise in the quantum of exports from these designated zones.** However, a closer look at the data given below shows how the momentum of growth of exports have been a little on the roller-coaster ride since 2005. This is a clear indicator of the sloppy planning, casual implementation of policies and over dependence on the ROW (rest of the world) since the Economic Reforms of 1991.

Exports from the operational SEZ's during the last nine years:

Years	Exports		Growth over previous year
	Value in (Rs. Crs)	US $ (Bn)	
2005-2006	22,840	5.08	–
2006-2007	34,615	7.69	52%
2007-2008	66,638	14.81	93%
2008-2009	99,689	22.15	50%
2009-2010	2,20,711	49.05	121%
2010-2011	3,15,868	70.19	43.11%
2011-2012	3,64,478	81.00	15.39%
2012-2013	4,76,159	88.18	31%
2013-2014	4,94,077	82.35	4%

Source: SEZ.nic.in

The general rule of trend analysis stresses upon a stable growth momentum. On the contrary, the data shows a zig-zag growth momentum, from a healthy 52% in 2006-07 to a commendable 93% in the next fiscal year which had slipped back to 50% in the year 2007-08. The spurt in growth in the next year had been magnificent and at the top 121% in the year 2009-10. This becomes all the more important since the world was facing the beginning of the downward trend in this period due to the recession started the US that swept one of the biggest institution of all times the 'Lehman Brothers'.

The recession once again proved that in this globalized world, if one major economy in hit by recession, the rest of the world would feel the ripples of the same. This is very much supported with the data given above. We were on the downstream thereafter with drastic fall to 43.11% to 15.39% in the next two fiscal years. Although the value of exports in absolute terms is on the rise, the rate of growth of this value is a matter of concern. We can only be hopeful of the better days ahead for a better future of SEZs in India.

Before winding up my presentation, I would like to discuss the key challenges in the SEZs programme of India. Experts are of the view, if we can concentrate on these key issues then Indian SEZs can also stand very well in competition with their Chinese counterparts.

Friends, I believe that you call can think of various reasons like SEZ policy, planning issues, land acquisition related matters along with re-habitation policy and many more in this direction for the visible delays in reaching desired goals.

Suggestive Measures to Promote SEZ in India

- **1. Reducing Corruption**
- **2. Locating SEZs**
- **3. Single Window Clearences**
- **4. Satisfactory Compensation for Acquisition**
- **6. Ease of doing Business**
- **6. Employment in Landless Labours**

With this, my dear friends, we hope that it was a productive and informative for everyone. Thanks for being a patient listener.

The class gave the group a standing ovation for their efforts on the topic and there was a sense of fulfillment in the eyes of the economics teacher which only a teacher can understand when his students come out with flying colours.

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SAMPLE QUESTIONS AND MARKING SCHEME

Q.1 Explain how the systematic 'opening up' has helped China to achieve desired results of growth? (5 Marks)

Suggested Answer: Value Points (Any other valid point by the student should also be given marks)

- Systematic 'opening up' helped China to focus on targeted areas.
- The focal point was the resource mobilization for the export promotion.
- Efficient use of PPP (Public-Private Partnership) model.
- Support to SEZs with structural reforms by the government.
- Strategic geographical location advantages.

(To be assessed as a whole)

Q.2 'India had faltered from the growth trajectory after the establishment of Kandla EPZ'. Do you agree? Give reasons in support of your answer. (5 Marks)

Suggested Answer: Value Points (Any other valid point by the student should also be given marks)

- Improper locations.
- Too much stress on import substitution.
- Inefficient use of PPP (Public-Private Partnership) model.
- Lack of structural support.
- Ineffective land acquisition/rehabilitation policies.

(To be assessed as a whole)

OPEN TEXT–BASED ASSESSMENT

ECONOMICS CLASS-XI

Theme–2: Indo-Pak Trade Relations

Abstract

India and Pakistan, South Asia's two largest countries, share a common border, culture and history. Yet despite their proximity and other similarities, the two countries barely trade with each other. India's trade with Pakistan accounted for less than half a percentage point of India's total trade in 2010, and Pakistan's trade with India was less than 5 percent of its total trade. Potential for future growth in trade is high and both countries are bound to gain from it. However, dedicated efforts in this direction are required from both the sides.

Indo- Pak Trade Relations

All countries need goods and services to satisfy wants of their people. Production of goods and services requires resources. Every country has only limited resources. No country can produce all the goods and services that it requires. It has to depend upon other countries for importing the goods which are either not available with it or are available in insufficient quantities. Similarly, it can export goods, which are in excess quantity with it and are in high demand in other countries.

Foreign Trade (or International trade) is exchange of capital, goods and services across international borders or territories. It involves different currencies and is regulated by laws, rules and regulations of the concerned countries. Industrialization, advanced transportation, globalization, multinational corporations and outsourcing etc. have a major impact on the foreign trade system. Increasing foreign trade is crucial to the continuance of globalization.

Source: (http://www.hsc.csu.edu.au/economics/global_economy/tut7/Tutorial7.html)

Foreign trade is, in principle, not different from domestic trade as the motivation and the behavior of parties involved in trade do not change fundamentally. The main difference arises because transactions take place across an international border. A border typically imposes additional costs such as tariffs, time, costs due to border delays and costs associated with country differences such as language, legal system, culture, currency exchange rates etc.

While foreign trade has been present throughout much of history, its economic, social, and political importance has been on the rise in recent centuries.

In most countries, it represents a significant share of Gross Domestic Product (GDP). Foreign trade is recognized as one of the most significant determinants of economic development of a country all over the world.

Foreign Trade Policy of India

Every country aims to regulate and create necessary environment for orderly growth of its foreign trade. The foreign trade of India is guided by its Exim Policy or Foreign Trade Policy. It is a set of guidelines and instructions established by the DGFT (Directorate General of Foreign Trade) in matters related to the import and export of goods in India. It contains various policy and procedure related decisions taken by the government with respect to exploring export potential, adopting export promotion measures, improving export performance, encouraging foreign trade and creating favourable balance of payments position etc. Various acts have been passed to strengthen the policy, like:

- Foreign Trade (Development and Regulation) Act, is to provide the development and regulation of foreign trade by facilitating imports into, and augmenting exports from India. Foreign Trade Act has replaced the earlier law known as the Imports and Exports (Control) Act 1947.
- Payments for import and export transactions are governed by Foreign Exchange Management Act, 1999.
- Customs Act, 1962 governs the physical movement of goods and services through various modes of transportation.
- To make India a quality producer and exporter of goods and services, an important Act namely- Exports (Quality Control & Inspection) Act, 1963 has been in place.

India and Pakistan

India and Pakistan were divided after the Partition in 1947. Pakistan lies to the west of India. Indian states of Jammu and Kashmir, Punjab, Rajasthan and Gujarat share borders with Pakistan.

Pakistan has a coastline on the Arabian Sea and so does India. Besides India, the Islamic Republic of Pakistan (official name) is bordered by Afghanistan, China and Iran.

India and Pakistan share a long and one of the most complex borders of length of 2,900 km with each other. Due to the various historical, geographical, political, cultural and other factors, trade between these two countries is an interesting area of study.

India and Pakistan: Trading Partners

The relationship between both countries has seen various ups and downs due to historical and political reasons. Trade between India and Pakistan at any point of time, also depends on the strength of the relationship as well as the foreign policies of both the countries. When they are at friendly terms, their trade volume increases to a greater extent.

India and Pakistan have been trading with each other since 1947 with a hiatus of nine years i.e. 1965-74. At the time of independence, the two countries were heavily dependent on each other. In fact India's share in Pakistan's global exports and imports accounted for 23.6% and 50.6% respectively in 1948-49. This declined to 1.3% and 0.06% in 1975-76. Similarly, Pakistan's share in India's global exports and imports was 2.2% and 1.1% respectively in 1951-51 which gradually went down to 0.7 and 0.13% in 2005-2006.

Trade between India and Pakistan takes place through three channels:

1) The formal trade, which is through official means. Compared to global figures this type of trade is marginal.
2) The illegal or informal trade; it takes place through smuggling via porous Indo-Pak land borders and through Afghanistan;
3) Trade also takes place through third countries. These include mainly Dubai and Singapore, which are free ports and accommodate legal agents of traders from both India and Pakistan.

It is also interesting to note that, whatever the nature of the relationship between Pakistan and India is, trade goes on through third country routes and smuggling and through family travels to the both sides of the countries.

Indo-Pak Formal Trade:

This is a bilateral formal trade, which is officially reported and recorded at the borders or ports of Pakistan and India.

The following news item published in a Pakistan daily throws light on the current scenario:

Trade between India and Pakistan surges 21% to $2.4 billion

By Our Correspondent

Published: May 14, 2013

Islamabad: Bilateral trade between India and Pakistan grew 21% to $2.4 billion last year, as Islamabad reaped the benefits of trade normalisation more than the gains made by New Delhi, says the Indian High Commission.

According to latest figures of the Directorate General of Commercial Intelligence and Statistics, Ministry of Commerce and Industry India, which were released here on Monday, the volume of bilateral trade recorded a net increase of $410 million from April last year to March this year.

Pakistan's exports to India grew 28% while Indian exports to Pakistan increased 19%. Bilateral trade has increased to $2.4 billion, which may soar to $6 billion in the next two years if both countries decide to treat each other equally.

According to an official statement released by the Indian High Commission in Islamabad, Pakistan's exports to India in the last Indian financial year (April 2012-March 2013) grew 28% and reached $513 million. Metalliferous ores and metal scrap, organic chemicals, raw cotton and leather were among the commodities that contributed significantly to the increase. The High Commission termed the 28% increase in Pakistan's exports "impressive" when viewed in the context of negligible increase in India's overall imports. India's exports to Pakistan in the same period increased $300 million, a growth of 19%. Total Indian exports to Pakistan stood at $1.84 billion, putting the trade balance in favour of New Delhi.

"The growth in bilateral trade, especially in Pakistan's exports to India, reflects the positive effect of a number of steps taken towards fully normalised trade relations," the High Commission stated. It added three bilateral agreements signed in 2012 in the areas of customs cooperation, mutual recognition of standards and addressing trade grievances were intended to further improve trade environment.

In February last year while taking a giant leap forward, Pakistan abolished the positive list containing only 1,956 tradable items and enforced a negative list of 1,209 untradable items until both sides agree on absolute trade normalisation.

Published in The Express Tribune, May 14th, 2013.

Here are some more figures worth pondering upon:

Bilateral Trade Between India and Pakistan				
				(In US$ Million)
Year	**Export**	**Imports**	**Total Trade**	**Balance of Trade**
2005–06	689.23	179.56	868.79	509.67
2006-07	1350.09	323.62	1673.71	1026.47
2007-08	1950.53	287.97	2238.5	1662.56
2008-09	1439.88	370.17	1810.05	1069.71

2009-10	1573.32	275.94	1849.26	1297.38
2010-11	2333.62	332.51	2666.13	2001.11
2011-12 (Apr.-Jan.)	1268.32	294.5	1562.82	973.82

Trade Gates at Indo Pak border

Indian trucks ready to move into Pakistan
(Source: http://www.livemint.com/Politics/9f5kNKuVPasQn8LOFkMfjP/Saarc-countries-hope-to-finalize-traffic-pact.html)

Movement of goods from Pakistan into India through Formal route
(http://www.oneindia.com/india/customs-to-set-up-under-vehicle-scan-system-in-indo-pak-border-1643686.html)

Indo-Pak Informal Trade:

Informal or illegal trade generally takes place due to the following reasons:

- Restrictions on import of specific items for various reasons such as health issues, religious beliefs or economic reasons;
- High tariff barriers or transportation costs which make it cost effective to smuggle the goods in the country; and
- Imposition of non-tariff barriers such as quantitative restrictions;
- Distortions in domestic policies such as the absence of or relatively low indirect taxes in a country which create an incentive to transport items illegally to neighboring countries.

The smugglers/traders mainly carry out the informal trade between India and Pakistan through the exchange of goods at the Indo-Pak border as well as through the misuse of the personal baggage scheme through the "green channel" facilities at international airports or railway stations.

Trade is also taking place through Afghanistan whereby goods are exported officially from India to Afghanistan and later on smuggled into Pakistan through Peshawar, which lies close to the Pakistan-Afghan border. Indian-made goods which are being smuggled into Pakistan include cosmetics, alcoholic beverages, stainless steel utensils, ayurvedic medicines, videotapes, cassettes, confectioneries and cashew nuts, tea and coffee etc. Informal exports from Pakistan to India cover items such as plastic goods, melamine dinner sets, food items such as edible oil and vegetable ghee, synthetic fibers and some chemical products.

The Sustainable Development Policy Institute (SDPI), Islamabad has conducted an extensive research on the informal trade between Pakistan and India and has estimated the value to be about 0.5 to 1 billion US $. Some other economists put the figure at almost 3 billion $. The balance of informal trade, as for the formal trade, is overwhelmingly in India's favour. Informal trade between the two countries is conducted through as many as eleven routes. The greatest volume of trade is carried out via Afghanistan. Though the exact value cannot be calculated the fact remains that significant amount of informal trade takes place between the two countries. This is indicative of the future trade potential between Pakistan and India.

Trade through Third Countries:

Trade through third countries or circular trade (technically official trade) is mainly conducted through agents operating in free ports like Dubai or Singapore. Circular trade is also taking place through the Central Asian Republics. According to the unofficial estimates, the total size of illegal and circular trade is estimated to be much larger than the official trade between the two countries.

Exports from India to Pakistan through third country routes include capital goods, textile machinery, dyes and chemicals, iron and ore, spices tannery equipments, machine tools and equipment/spares, cotton fabrics, tyres, chemical products, medicines, videotapes, alcoholic beverages, viscose fiber and tea. The size of circular trade through third countries underlines the potential of flourishing bilateral trade between the two countries. Indian tyres, textile machinery, tea, coffee, chemicals and drugs are favored by Pakistanis; however they have to pay inflated prices for these goods coming through indirect routes.

SAFTA

No discussion on trade between any South Asian countries would be complete without mention of SAFTA. South Asian Free Trade Area (SAFTA) is a trade agreement between SAARC nations, reached on 6 January 2004 at the 12th SAARC summit in Islamabad, Pakistan. It envisaged a free trade area of about 2.0 billion people of Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka. The seven foreign ministers of the region signed a framework agreement on SAFTA to reduce customs duties of all traded goods to zero by the year 2016. (Afghanistan joined SAFTA later)

The SAFTA agreement came into force on 1 January 2006.

The objective of the agreement is to promote competition in the area and to provide equitable benefits to the eight countries involved. SAFTA hopes to increase the level of trade and economic cooperation among the SAARC nations by reducing the tariff and non tariff barriers and also to provide special preference to the Least Developed Countries in South Asia (Nepal, Bhutan, Bangladesh, Afghanistan and Maldives)

The issue of Most Favoured Nation Status

In the attempt to improve relations between Pakistan and India in the recent past, an increased emphasis has been given to the issue of granting the Most Favored Nation (MFN) status to India. Pakistan and India are among the 25 founding members of the GATT. One of the fundamental principles of GATT is the MFN clause according to which any trade concession granted to one member of GATT must be extended to all members. Moreover, after the acceptance of the WTO Agreement, Pakistan has recommitted itself to the principles of GATT to pursue the objectives of free trade in a non-discriminatory multilateral framework. As a signatory to the Agreement, Pakistan is bound to grant MFN status to all member countries including India without any kind of discrimination. Contrary to the popular view, MFN does not mean giving special treatment to imports from any particular country i.e. MFN status does not translate into trading 'freely' with India; it means trading with India in the same way as Pakistan trades with the rest of the world. The principle requires that any favorable treatment given to one member of the WTO, such as lower tariffs or greater market access, has to be extended to import of similar products from all other member countries. For instance, following the grant of MFN status, the US and China simply began to trade with each other on the same footing as with the rest of the world.

Instead of granting MFN status, Pakistan has gradually increased the number of items permissible for trade with India. The trading community in Pakistan seems to be in favour of granting the MFN status to India. The Karachi Chamber of Commerce and Industry (KCCI) has already recommended to the Government to grant MFN status to India because, in their view, it is unlikely that it will cause any damage to the Pakistani industry. Pakistani authorities, however, feel that liberalizing trade between the two countries, after granting MFN status to India, will mostly benefit India given that it possesses a substantial industrial and engineering base. By conceding MFN status, Pakistan feels that it will suddenly expose its economy to the well diversified industrial structure of a large economy enjoying a substantial transport cost advantage over all its competitions. Moreover, it is also felt that dumping of cheap Indian products may also be likely which will pose problems for Pakistan.

India granted MFN status to Pakistan in 1996 but Pakistan has not yet reciprocated in the same manner. Since then India has been urging Pakistan to grant MFN treatment to India as well because such a status will ease qualitative and quantitative restrictions on the flow of goods between the two countries.

Another hurdle in free trade is related to Pakistan not maintaining a negative list against India.

There are two approaches to foreign trade

1) In the negative list approach, trade in all commodities is permitted and unregulated unless specific measures are set out in the list of reservations. This is a liberal form of trade.

2) In the positive list approach, only commodities can be traded which have been systematically evaluated and approved. This is a restrictive form of trade.

Pakistan still maintains a positive list for trade with India. This goes against the very spirit of SAFTA. Also it encourages informal and illegal trade between the countries which is not good for both economies.

What needs to be done?

Most certainly Indo-Pak trade which today stands at a mere $3 billion with a possibility of reaching $40 billion is huge potential that needs to be exploited .

A number of steps need to be undertaken to help improve mutual trade and realize the untapped trade potential. Several physical and regulatory impediments need to be addressed. There is a dire need of drawing a rigorous framework for trade that should be formulated independent of any political pressure. Some of the measures are:

- Non-tariff barriers should be removed for smoothening the bilateral trade.
- More trade routes should be discovered for bilateral trade between both the countries.
- More means of transportation should be developed and number of flights and trains and bus tours should be increased.
- Courier service should be initiated and extended to all major cities of Pakistan and India.
- Opening up and connecting seaports in both countries via Arabian Sea can give a big boost to Indo-Pak trade.
- Organizing more exhibitions and trade fairs are an effective way of dealing with 'perceived barriers'.
- Third-country traders, such as those in Dubai, have played a significant role as facilitators between Indian and Pakistani traders. Even as tariff and non-tariff barriers are lowered, it is only when business partnerships between India and Pakistan materialize directly through market forces, payments are ensured, and trust in business relationships is established we can ensure greater formal trade with Pakistan.
- For deeper and stronger trade linkages, it is important that the bilateral visa regime be liberalized without compromising on security, and there is free flow of investments between the two countries. As a positive step, India has now permitted outward and inward flows of Foreign Direct Investment (FDI) to and from Pakistan.
- Enhancing communication, by facilitating people-to-people interactions and bridging existing telecom network gaps, can also prove effective in furthering India-Pakistan trade relations.

Thus, India strongly believes that the time is most opportune for two neighbouring countries of South Asia to overcome their past baggage of tension-prone economic and trade relationship and move forward with new hopes and aspirations to build an economically powerful bilateral relationship. The major beneficiary of trade between India and Pakistan will be the consumers, as it will give them low cost goods and services due to reduced cost of production and large economies of scale. It will enhance the savings capacity of the people, which would have positive visible effects on social indicators such as education, health and nutrition.

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SAMPLE QUESTIONS

1. Do you think that increasing formal trade with India could be advantageous for economy of Pakistan? Give reasons to support your answer. (5 Marks)
2. When two countries trade goods and services there are various hurdles that have to be faced. Discuss. (5 Marks)

MARKING SCHEME

1. Trade can be advantageous for Pakistan due to the following reasons (5)
   - Pakistan BOT will improve
   - Customs revenue will increase due to increased imports from India
   - Overall growth in job opportunities due to higher production for exports
   - Any other relevant points

   OR

   Trade can be disadvantageous due to

   - Some industries like automobiles, steel etc may suffer due to imports from India
   - Dumping
   - Any other relevant points

   (To be assessed as a whole)

2. Hurdles arise due to long distance transportation, language and cultural differences, currency exchange rates, documents and legal paper work requirement, assessing changes in consumer behaviour etc. Brief explanations. (5)

   (To be assessed as a whole)

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