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India-Pakistan trade: Perspectives from the automobile sector in Pakistan

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Working Paper 293

India-Pakistan Trade: Perspectives from the Automobile Sector in Pakistan

**Vaqar Ahmed
Samavia Batool**

January 2015



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List of Abbreviations

AIDP	Auto Industry Development Programme
ACMA	Auto Component Manufacturers Association (India)
ATT	Afghan Transit Trade
BRCA	Bilateral Revealed Comparative Advantage
CBU	Completely Built Up
CCP	Competition Commission of Pakistan
CIF	Cost, Insurance and Freight
CKD	Completely Knocked Down
CPD	Convergent Parallel Design
CVD	Countervailing Duties
EDB	Engineering Development Board
FPCCI	Federation of Pakistan Chambers of Commerce and Industry
FTA	Free Trade Agreement
IPP	Institute of Public Policy
INR	Indian Rupee
ITC	International Trade Centre
JICA	Japan International Co-operation Agency
LCVs	Light Commercial Vehicle
MFN	Most Favoured Nation
MMR	Mixed Method Research
MNC	Multinational Corporation
NTB	Non-tariff Barrier
OEM	Original Equipment Manufacturer
PAAPAM	Pakistan Association of Automotive Parts Accessories Manufacturers
PACO	Pakistan Automobile Corporation
PAMA	Pakistan Automotive Manufacturers Association
PKR	Pakistani Rupee
PSQCA	Pakistan Standards and Quality Control Authority
PTA	Preferential Trade Agreement
SAFTA	South Asian Free Trade Agreement
WHT	Withholding tax
TCI	Trade Complementarity Index
TDAP	Trade Development Authority of Pakistan

Abstract

The auto sector in Pakistan has been a persistent opponent of trade liberalisation in the country. This has entailed losses to consumers in terms of higher prices, low safety and quality standards, and lack of innovation in this sector. The deletion programme, which was to result in indigenization of final output, has also failed to deliver expected results.

The market structure of this sector, particularly in the case of cars, is narrow with only three Japanese companies monopolising the market. Even when import of older vehicles was allowed in Pakistan, it was used Japanese vehicles that were imported the most. This has prevented competition in this sector, and many respondents in our market survey have revealed that if cheaper auto sector inputs and raw material are allowed and imports are facilitated from China and India, new entrants (both domestic and foreign) may enter production.

Pakistan also has a comparative advantage in several auto sector components/classifications. However, these do not find their way, for example, to India due to what the industry describes as non-tariff barriers, state-specific levies and unconventional environmental standards required by Indian authorities. This paper proposes a way forward whereby the commerce ministries of India and Pakistan can address the concerns of Pakistan's auto sector and create a win-win milieu. However, this alone will not be enough. We explain in this paper that several institutions in Pakistan such as the National Tariff Commission, Ministry of Industries, Engineering Development Board, Federal Board of Revenue, and PSQCA will also have to play their role in challenging domestic manufacturers and opening up the auto sector for competition, which will help consumers in Pakistan and lead to job creation.

JEL Classification: F13, F14, F15, L11, L65

Key Words: Trade, Automobile, non-tariff barriers, India, Pakistan

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India-Pakistan Trade: Perspectives from the Automobile Sector in Pakistan

Vaqar Ahmed and Samavia Batool

1. Introduction¹

The auto sector in both India and Pakistan has shown growth in terms of production, trade and employment. Improved global trade in auto parts has also allowed better supply chain opportunities for both countries. The trade diplomacy climate has improved sufficiently to push ahead with trade dialogues at both the track-I and II levels. This is seen in the increased number of cross-border meetings between government officials and the business community. At the time of writing this document, there had been non-stop trading activity at the Wagah-Attari border for the past 28 months. Trading hours and days have increased recently with better trade-related infrastructure (e.g. scanners and standards validation instruments) available on the land route. There is also a heightened debate now on opening up other land routes with India, e.g., Munabao-Kokhrapar border.

The Government of Pakistan has once again promised to revisit the grant of MFN status to India. According to the Pakistan government, it is crucial to adopt a sector-specific approach and identify sector-wise gains and losses as a result of liberalised trade. One of the key sectors in which the manufacturing community fears trade liberalisation would result in dumping from the Indian side is the auto sector. It is feared that high production subsidies in India, non-tariff barriers on the Indian side and a continuing energy crisis in Pakistan may imply greater relative gains for India in this sector. However, Pakistan has liberalised automobile trade with several other economies. It is now usual to see auto parts and even second-hand cars coming from Japan, the United Arab Emirates and the European Union. These imports have still not threatened the competitive advantage of local manufacturers because of their higher freight costs. However, in the case of China or India, such trade has not been allowed because of the cost advantages these two countries enjoy.

While India and Pakistan both potentially stand to gain enormously by liberalising trade, there have been divergent views in Pakistan on opening trade with India, especially in case of automobiles (Ahmed et al, 2013; Ahmed et al, 2014). It is, therefore, crucial to investigate the relative gains and losses for Pakistan's automobile industry. Intuitively, any easing of trade barriers will imply gains in terms of reduced input costs as well as lower margins. Theoretically,

¹ This paper has been written as part of research studies conducted under the project "Strengthening Research and Promoting Multi-level Dialogue for Trade Normalisation between India and Pakistan" led by Dr. Nisha Taneja. The authors are thankful to Dr. Nisha Taneja, Dr. Mihir Pandey, Dr. Meenu Tiwari, Dr. Sanjay Kathuria and Dr. Saikat Sinha Roy for comments.

trade-induced competition is likely to bring down domestic prices and increase consumer surplus.

This study has the following broad objectives:

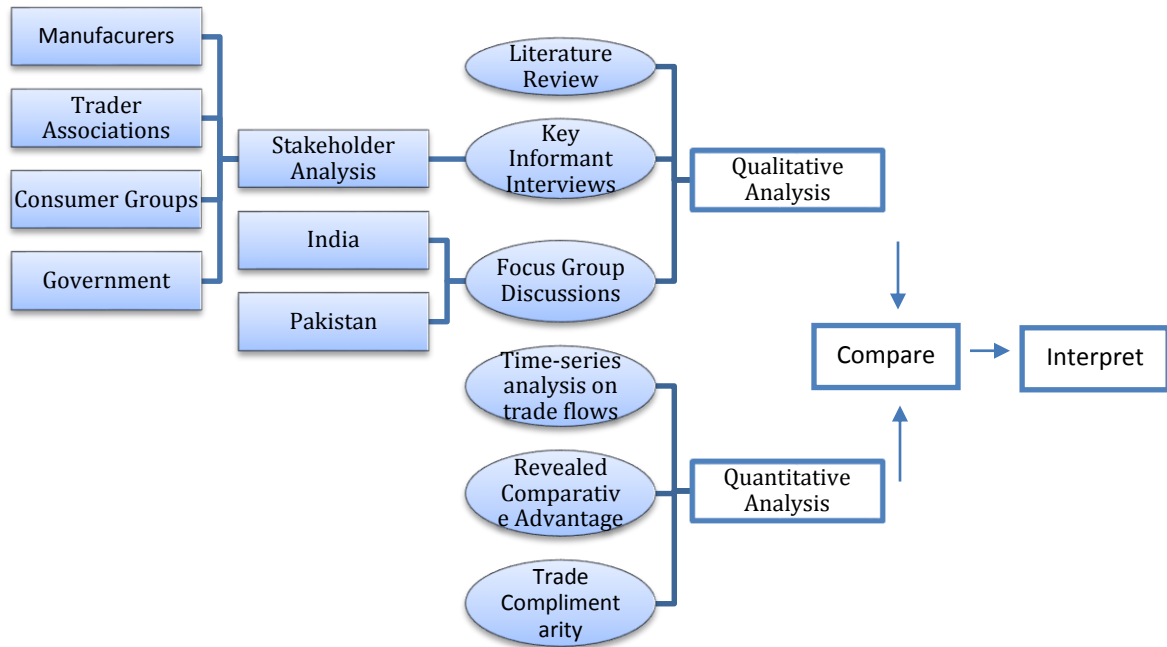
1. To analyse the competitiveness of Pakistan's automobile industry
2. To explore the automobile import and export patterns of India and Pakistan, identifying the most exported and imported automobile products and major automobile trade partners
3. To identify the obstacles that impede cross-border trade in automobiles
4. To analyse if Indian auto parts can potentially substitute for imports of auto parts from the rest of the world to Pakistan
5. To explore the economic justifications of placing automobile products in Pakistan's negative list vis-à-vis India
6. To study trade and investment policies regulating the auto sector in the two countries

The next section describes the methodology used in this study, followed by an overview of the automobile sector and the trade structure of the auto industry in Pakistan. It also looks at the price differential for automobile products across borders. We then calculate revealed comparative advantage and trade complementarity for the two neighbours to identify products with trade potential. This is followed by an analysis of views from various stakeholders, possible avenues of joint ventures and finally, the way forward and policy recommendations.

2. Methodology and Data

Our approach rests on both qualitative and quantitative survey tools and combines and interprets both types of analyses to arrive at policy relevant conclusions (Figure 1). Earlier works by Ahmed (2013), the Competition Commission of Pakistan (2013), IPP (2013), Hussain (2011), Japan International Co-operation Agency (2011), Veloso and Kumar (2002) were reviewed to identify the strengths, weaknesses, opportunities and challenges with respect to trade for the Indian and Pakistani automobile industries.

Figure 1: Methodological Framework



The key informant interviews (KIIs), and focus group discussions (FGDs) have helped to build the qualitative part of this study. We conducted 15 KIIs with officials representing automobile manufacturers, auto parts manufacturers, automobile/auto parts manufacturers association, Ministry of Commerce, Federal Board of Revenue (FBR), Engineering Development Board (EDB) and Trade Development Authority of Pakistan (TDAP).

We also conducted two FGDs, one each in India and Pakistan, with major stakeholders from both sides of the border. Unlike past efforts to study this subject, we have taken special care to include consumer groups. The representation by consumers has allowed us to study the welfare effects in both price and quality terms, if trade is liberalised.

The bilateral revealed comparative advantage index (Serin and Civan, 2008) and trade complementarity index (Michael, 1996) for chapters 84 and 87 of the HS classification were calculated. Time series data for the period 2005 to 2012 was extracted from the International Trade Centre database in order to carry out an in-depth descriptive analysis. Trade data for 2013 has been used to identify trade partners and the major traded items in the automobile sectors of the two countries. Other industry specific data was obtained from PAMA, PAAPAM, EDB, FBR and TDAP.

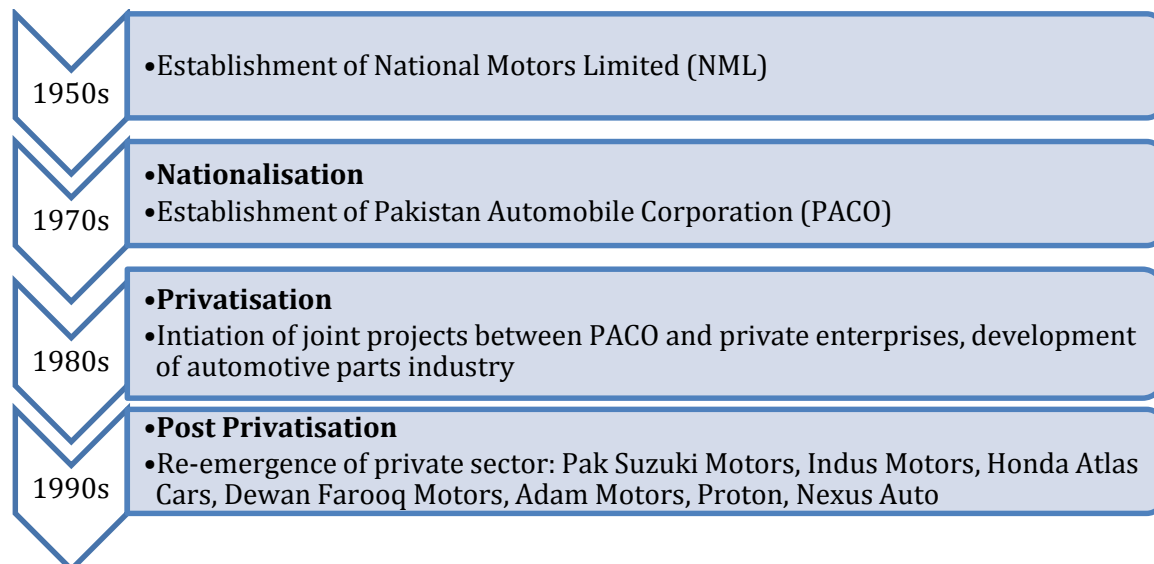
3. Automobile Industry in Pakistan

The automobile industry is the sixth largest manufacturing sub-sector in Pakistan. It has registered impressive growth in the last few years with an annual growth rate of above 7 per cent

since 2007. The auto sector's annual contribution to GDP amounts to approximately US\$6 billion.² It also generates 215,000 direct job opportunities and contributes US\$0.82 billion to revenue collection through indirect taxes (CCP, 2013). This sector also contributes 16 per cent to the manufacturing sector of Pakistan.

With substantial potential for job creation along with forward and backward linkages in allied industries, the auto sector in Pakistan is gradually becoming a key player in economic growth and trade composition. The steady growth in domestic demand for automobiles has allowed Pakistan to become one of the few countries with specialisation in the production of all kinds of vehicles including 2/3 wheelers, motorcars, LCVs, tractors, prime-movers and trucks. Local manufacturers cater to most of the automotive demand in the country except for a few categories of trucks and prime-movers, which are imported (AIDP, 2006). A brief timeline of the automobile industry is presented in Figure 2.

Figure 2: Evolution of Automotive Industry in Pakistan



Based on JICA (2011) and CCP (2013)

3.1 Evolution and Key Players

According to the CCP (2013), 11 models produced by 4 manufacturers account for most of the automobile sales in Pakistan. The major players in the Pakistani automobile industry are Suzuki, Toyota and Honda with a market share of 62 per cent, 28 per cent and 9 per cent respectively. The remaining producers have a minor share of 1.4 per cent in the automobile market and include Dewan Farooque Motors Ltd, Sigma Motors Ltd, Hinopak Motors Ltd, and Gandhara Industries Ltd.

² Updated from Jalil (2012).

EDB (2013) reports that most automobile manufacturers in Pakistan have technical collaborations with Japanese automobile firms. In 2012-13, Pakistani companies that had collaborations with Japanese companies had the largest share in automobile sales (Table 1). Japanese collaboration is also dominant in the LCV, truck and bus industry.

Table 1: Market Share (%) of Local Automobile Companies in Collaboration with Japan (2012-13)

Collaboration type	Car	Motorcycle	Truck	Buses	Tractors	Jeeps	LCVs/pick ups
Japanese	100	44	80	80	0	57	97
Non-Japanese	0	56	20	20	100	43	3

Source: EDB (2013)

Table 2 gives further details regarding the installed capacity, turnover and revenue contribution by automobile manufacturers in Pakistan. This table only includes PAMA member companies and excludes members for which data on the indicators mentioned is not available. The omitted categories include motorcycles, rickshaws, trucks and bus manufacturers. Indus Motors Ltd. has the highest turnover. Pak Suzuki Motors, however, has the highest installed capacity per annum.

Table 2: Specifications of Automobile Manufacturers in Pakistan

Manufacturers	Products	Installed Capacity (Units/ annum)	Turnover (PKR million)	Contribution to Exchequer (PKR million)
Pak Suzuki Motor Co. Ltd.	Cars, LCVs, Vans, Motorcycles	150,000	58,531	17,302
Indus Motor Co. Ltd.	Cars, LCVs, SUV	54,800	77,000	24,700
Honda Atlas Cars (Pakistan) Ltd.	Cars	50,000	30,275	10,664
Dewan Farooque Motors Ltd.	Cars, LCVs	20,000	-	8
Sigma Motors Ltd.	Jeeps	1,320	998	236
Hinopak Motors Ltd.	Trucks, Buses, P. Movers, LCVs	6,000+1,800	7,528	650
Ghandhara Nissan Ltd.	Cars, Trucks, Buses	8500 (Cars 6,000 + Trucks 2,500)	1,624	340
Master Motor Corporation Ltd.	Trucks, Buses, Pick ups	-	1150	289
Millat Tractors Ltd.	Tractors	-	20,133	1,426
Atlas Honda Ltd.	Motorcycles	750,000	38,011.857	7,700
DYL Motorcycles Ltd.	Motorcycles	200,000	3,942	722
Ravi Automobile Pvt. Ltd.	Motorcycles	75,000	1,027	46
Sazgar Engineering Works Ltd.	Rickshaws	20,000	2,725.64	605

Source: PAMA, 2013³

³ PAMA members with missing data are not included here.

Apart from manufacturers, Pakistan has a highly organised automotive vending industry. According to a representative of PAAPAM, there are nearly 2800 vending units in Pakistan of which 670 are organised and are classified as tier-I.⁴ Around 900 belong to tier-II category while 1230 units come under small and cottage units. Nearly 950 different auto parts are manufactured by the local vending industry. In 2012, auto parts worth US\$128 million were exported by Pakistan to various European countries, US and to some South Asian countries, particularly Bangladesh.⁵

3.2 Structure of the Industry

The Pakistani automobile industry operates under various agreements of franchising and technical co-operation with leading global manufactures. Broadly, it can be categorised into the following segments: cars and light commercial vehicles (LCVs), 2/3 wheelers, tractors, trucks and buses, and vendor industry (SBP, 2007). The Board of Investment (2007) states that most automobile manufacturers in Pakistan produce 2/3 wheelers and LCVs. The number of organised vendors involved in the auto sector stands at 250.

A recent study indicates that in terms of a broader categorisation of automobile manufacturers, there are currently 10-12 four-wheeler manufacturers, 90-100 two-wheeler manufacturers, 40-50 rickshaw manufacturers and 5-7 tractor manufacturers in Pakistan. A total of 149-165 auto companies are involved in manufacturing across Pakistan (JICA, 2011).

Classification on the basis of engine size reveals that currently there is only a single producer (Pak Suzuki) producing a car in the 800cc engine segment. Production of 1000cc engine cars is also carried out largely by Pak Suzuki. Honda Atlas, Pak Suzuki and Indus Motors (Toyota) compete with each other in the production of 1000+cc engine cars (CCP, 2013).

Moreover, data provided by EDB shows that the local automobile industry is on its way to achieving high levels of local content. The tractor industry has achieved the highest level of local content with nearly 80-87 per cent of the parts being locally manufactured (Table 3). The commercial vehicle and trucks and buses industry has the lowest level of local content, highlighting their dependence on imported parts. The critics of the deletion programme⁶ have argued that despite decades of protection to this industry, indigenous levels of production remain low. It is also argued that if the import of finished products is to remain high, there is a compelling case to import from the nearest neighbours, including China and India, to reduce the cost of production and improve consumer affordability.

⁴ Tier 3 companies supply small auto components to tier 2 vendors for assembling. These assembled parts are then supplied to tier 1 vendors for further assembling.

⁵ The EU countries mainly included Germany and Italy.

⁶ Deletion programme focused on progressively increasing the proportion of local parts in vehicle manufacturing.

Table 3: Percentage of Local Content

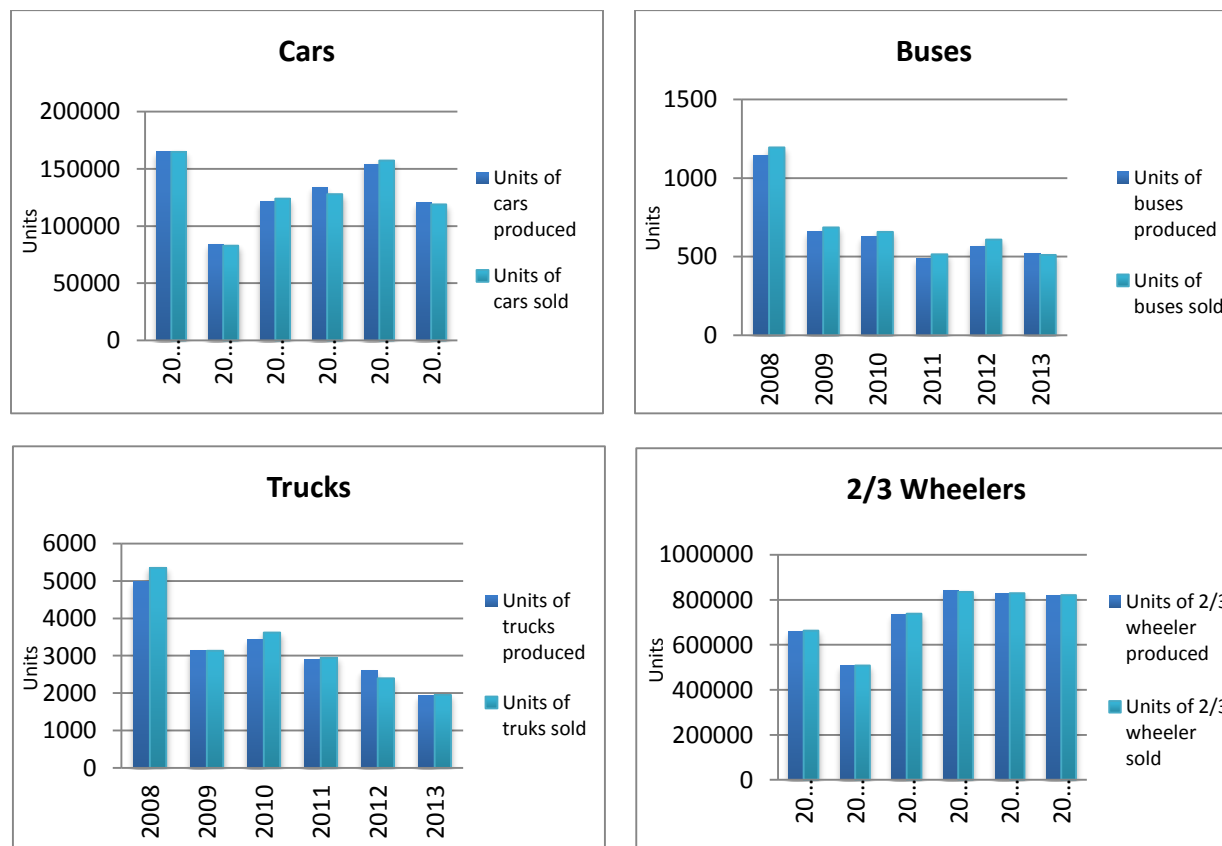
Auto Sector Categories	Local Content Level (%)
Tractors	88-87
Motor cycles	77-83
Cars	50-70
Buses / Trucks	45-47
Commercial vehicles	30-40

Source: EDB

3.3 Production structure

Product-wise sales and production of various automobile products are given in Figure 3. Although the domestic demand for automobiles is met by local manufacturers, in recent years, demand has outstripped supply. For example, in 2010, 121,647 units of cars were produced while 123,957 units of cars were sold, pointing towards a demand-supply gap. This gap seems to be more visible in the case of buses and trucks. Automobile import data reveals that the import of trucks and other motor vehicles for the transport of goods forms the second largest category of Pakistan’s automobile imports (US\$0.2 billion in 2012).

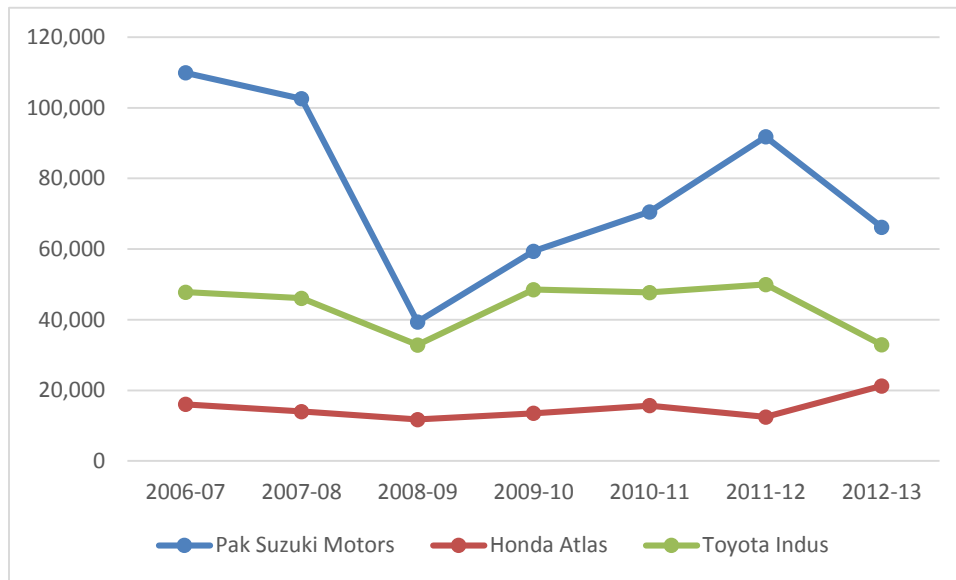
Figure 3: Production and Sales of Various Automobile Products



Data source: PAMA, 2013

Annual production of cars by the top three manufacturers is shown in Figure 4. We observe here that the industry is operating significantly below capacity. One major reason reported by representatives of PAMA and PAAPAM is the energy crisis in the country. Second, the production of small engine cars manufactured by Pak Suzuki Motors has declined in the year 2012-13. The production of Alto, of which 15,288 units were produced in 2011, was discontinued in 2012 by the manufacturer.

Figure 4: Annual production of cars



Source: PAMA & Industry via EDB (2013)

A further analysis of car production data based on engine size reveals that Pakistan’s automobile market is pre-dominantly occupied by large engine cars, i.e., above 1300cc, followed by 800cc cars. They also indicate a decline in production in 2012 as compared to 2011.

3.4 Market Structure

Pakistan’s automobile industry can be classified as a differentiated oligopoly (Friedman, 1983). It is evident that the market is predominantly occupied by the top three auto manufacturers. Prices are also likely to be rigid in an oligopolistic market. This rigidity may be seen in a situation in which a price increase by one producer is not matched by others while a decrease in price by one producer leads to a price reduction by the whole industry. For example, after the rupee appreciation in March 2014, Indus Motors is reported to have decreased the price of GLi and XLi by PKR 50,000 and Altis by PKR 75,000. This was followed by Honda Atlas, which reduced the price of Honda Civic by PKR30,000 and Honda City by PKR40,000 (as reported by the representative from EDB). The market structure is also sensitive to government intervention

(Box 1) through statutory regulatory orders (SROs) which provide exemptions, protection or preferential treatments to a sector or entity (for production or trade).

Box 1: SROs Related to Automobile Import

S.R.O. 577(I)/2005 provides for tax exemption (custom duty, sales tax and withholding tax) on the import of used automobiles (meant for transport of persons).

S.R.O. 655 (I)/2006 enables the automotive vending industry to import duty-free raw materials, sub-components and sub-assemblies not locally manufactured. Earlier, the import of these components was subjected to customs duty ranging from 5 per cent to 20 per cent. This exemption is subject to conditions of importers having extensive in-house production facilities etc.

Under **S.R.O. 656(I)/2006**, the government exempted some components of automobiles from custom duties, subject to certain conditions. The importer has to be a certified assembler or manufacturer having suitable in-house facilities. The in-house facilities are further defined in Annex-A of the SRO as having extensive assembling and manufacturing facilities. Moreover, a 10 per cent custom duty faced by CKD importers of motorcycles would be exempted if the importer complies with localisation policies.

Under **S.R.O. 693 (I)/2006**, the government levied additional custom duties of between 15 and 35 per cent on the import of auto parts listed in Appendix-I and II of the SRO notification. Various auto parts under chapter 40, 57, 68, 70, 73, 82, 83, 84, 85, 87, 90, 94 and 96 were subject to the increased duties.

S.R.O 277 (I)/2010 provides for custom duty exemption on the import of new cars by a disabled Pakistani national.

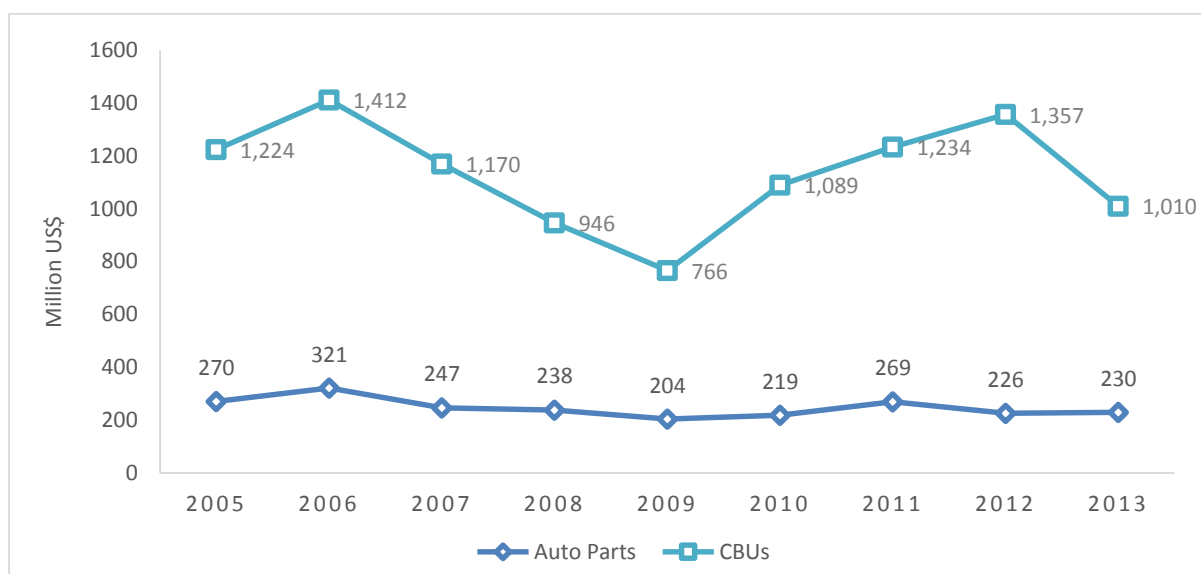
S.R.O 172 (I)/2013 deals with tax amnesty on the seizing or voluntary submission of smuggled/duty free motor vehicles. The submission of such vehicles to custom authorities before a prescribed deadline would enable release of the vehicle on payment of a redemption fine.

Source: Federal Board of Revenue (2014)

4. Automobile Trade of Pakistan

Figure 5 indicates that CBU imports have been on the rise since 2009 and peaked at US\$1.36 billion in 2012.⁷ By contrast, the import of auto parts declined in 2012. This decrease in auto parts can partly be explained by the increased import of used cars in 2011 as a result of an increase in the limit of the age of imported cars (from 3 to 5 years) during the year 2011.⁸

Figure 5: Auto parts and CBU Imports of Pakistan (Chapter 87)



Data Source: ITC Trade Map, 2013

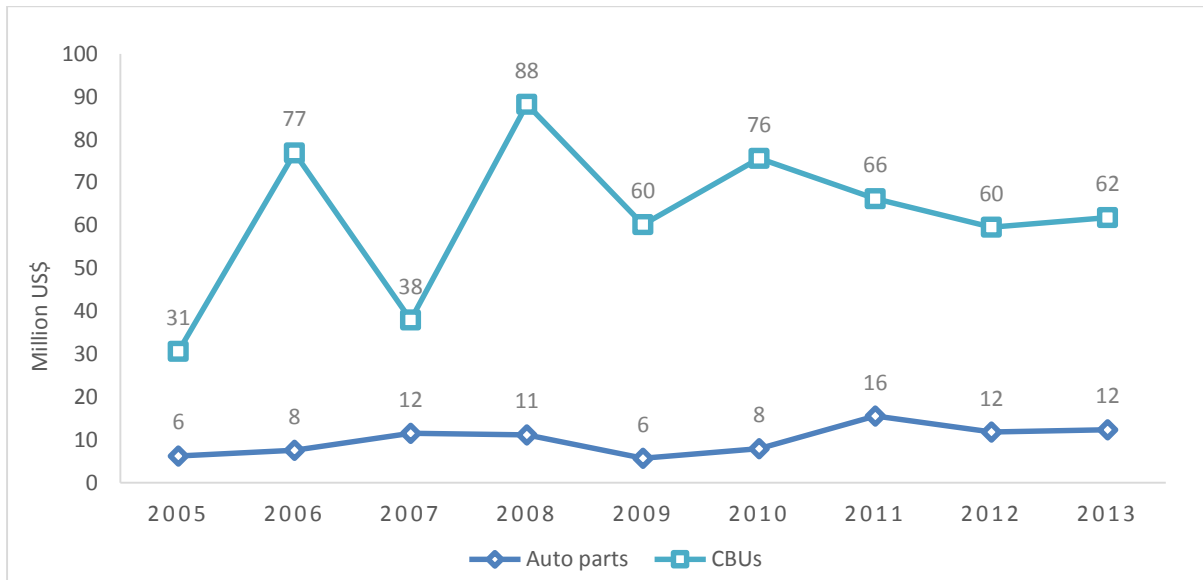
Export of CBUs had been volatile until 2010, and began to decline subsequently (Figure 6). On the other hand, the export of auto parts shows a somewhat stable trend. Exports gradually increased after 2009 and began to decline in 2011. The declining trend in automobile exports might be explained by the energy shortage in the country. This is particularly evident in the case of CBUs, whose exports declined after 2010, the time when the energy crisis became acute. Some of the auto parts manufacturers also suffered from declining exports, mainly as a result of decreased global demand for automobiles that can be attributed partially to higher oil prices.

Rafique (2011) states that automobile exports declined in 2009 after having been stable for years because of rising global commodity prices and expensive lease financing (increased market interest rate). Interestingly, Pakistan's imports and exports of CBUs are greater than that of auto parts, indicating a pattern of high intra-industry trade in CBUs.

⁷ Data of chapter 87 of the Harmonised System (HS) of classification is used via ITC. HS Classification is the standardised system of classifying traded commodities.

⁸ SRO 275 (I)

Figure 6: Auto parts and CBU Exports of Pakistan (Chapter 87)



Data Source: ITC Trade Map, 2013

Pakistan’s exports under chapter 87 represent 0.01 per cent of world exports while imports represent 0.12 per cent of world imports (ITC, 2013). The share of automobile imports in the country’s total imports has been rising since 2008 and in 2012, it accounted for 3.6 per cent of the country’s total imports. On the other hand, the share of automobile exports has remained stagnant at 0.2 - 0.3 per cent of the country’s total exports.

Afghanistan, Nigeria and Italy were Pakistan’s top 3 automobile export destinations in 2013 with shares of 9.5, 9.4 and 7.6 per cent respectively. The major countries from which Pakistan imported automobiles during that year were Japan (which accounted for 47.3 per cent of total Pakistani automobile imports), Thailand (22 per cent of auto imports) and China (11.7 per cent of auto imports).

4.1 Import of Used Cars

The import of used vehicles is allowed under the gift scheme, transfer of residence and personal baggage scheme (FBR, 2014). Government usually changes the conditions on this import to control the flow of used cars into the country. SRO 577(I)/2005 provides the fixed duty rate on the import of used cars in Pakistan (see Table 4). These duty rates are much lower than the tariff rates imposed on the import of new cars.

Table 4: Fixed Duty on the Import of Used Cars

Category	Fixed Duty on Used Cars (US\$)
Up to 800cc	4,400
800 to 1000 cc	5,500
1001 to 1300cc	11,000
1301 to 1500cc	15,400
1501 to 1600cc	18,700
1601 to 1800cc	23,100

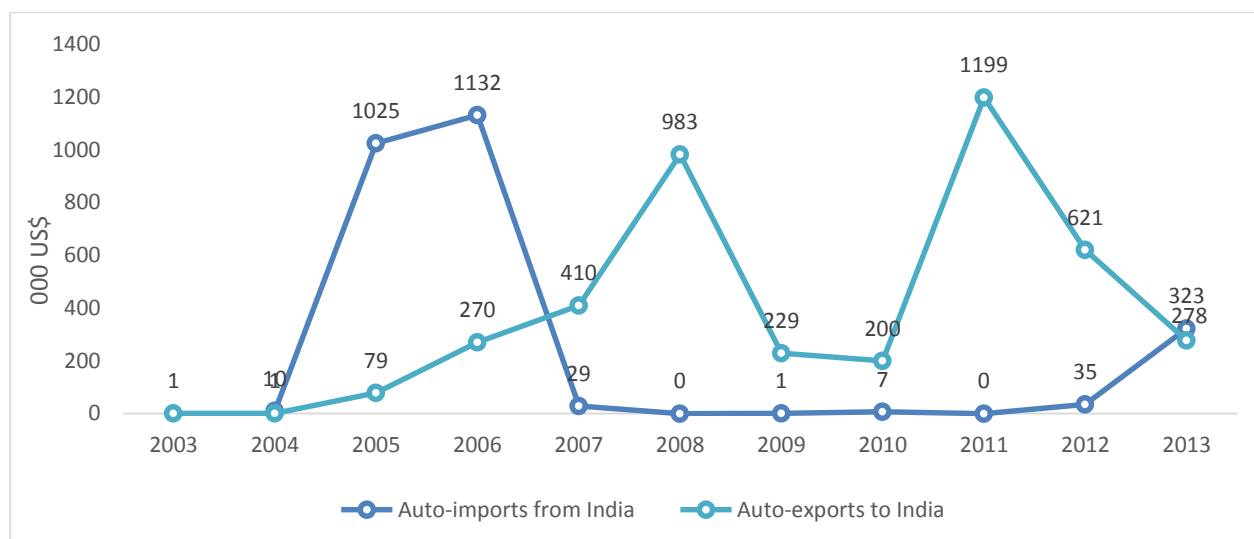
Source: SRO. 577(I)/2005, Federal Bureau of Revenue, Government of Pakistan

5. India-Pakistan Bilateral Trade in Automobiles

Trade between India and Pakistan in automobile products has been volatile over the past decade (Figure 7). There was a sharp decline in automobile trade between 2007 and 2010. Indian exports of automobile products could not find their way into Pakistani markets after 2007. Gopalan et al (2013) attribute the decline in India's exports to Pakistan to the increase in ad valorem tariffs by the Government of Pakistan in 2006-07 on the import of automobile products. The government also launched the AIDP in 2006, under which a 30-35 per cent tariff was levied on the import of auto parts and 10-90 per cent duty was imposed on the import of CBUs (AIDP, 2006). Unless these tariff barriers are removed, other trade enhancement measures are unlikely to deliver.

In 2013, auto imports from India stood at a meagre US\$278,000. On the export side, automobile exports to India increased from US\$79,000 in 2005 to US\$1.2 million in 2011. It again decreased to US\$0.3 million in 2013. Automobile exports to India were 0.4 per cent of Pakistan's total automobile exports while automobile imports from India were 0.02 per cent of Pakistan's total automobile imports in 2013.

Figure 7: India-Pakistan trade in Vehicles⁹ other than Tramway (Chapter 87)



Data source: ITC trade map, 2013

5.1 Product-wise Trade in Automobiles

India-Pakistan automobile trade is much below potential, a fact that has been highlighted in various studies including Hussain (2011) and Ahmed (2013). Pakistan imports auto products in five product groups (at the 6-digit level) while it exports products to India from three product groups of the HS classification (Chapter 87). Table 5 shows that Pakistan mostly imports CBUs from India rather than auto parts. Work truck parts and motor vehicle parts are imported as auto parts.

Table 5: Bilaterally traded automobile products Chapter 87 (2013)

Pakistan's imports from India			Pakistan's exports to India		
Product code	Product label	Value in 2013, (000US\$)	Product code	Product label	Value in 2013, (000US\$)
870590	Special purpose motor vehicles	179	870899	Motor vehicle parts	214
870120	Road tractors for semi-trailers (truck tractors)	86	870840	Transmissions for motor vehicles	63
870990	Work truck parts	46	871690	Trailer and other vehicle parts	1
870919	Work trucks not electrically powered	9			
870899	Motor vehicle parts	4			
Total		324	Total		278

Data source: ITC Trade Map, 2013¹⁰

⁹ This Chapter includes cars, trucks, tractors, motorcycles, bicycles, tanks and trailers. But trade with India only takes place in the few categories presented in Table 6.

Comparison of product-wise automobile imports of Pakistan (chapter 87) with the rest of the world and India reveals that the difference in these two trade values is significant enough to revisit Pakistan's trade policy with India (Table 6). Several consumer groups have pointed towards the welfare loss incurred due to expensive imports from the rest of the world.

A substantial difference also exists in Pakistan's import of auto parts (chapter 84) from the rest of the world and from India. India can provide similar auto parts at low freight costs, and Pakistan should consider importing auto parts from India in the interest of consumer welfare. The fact that these auto parts are exported in large amounts by India to the rest of the world is indicative of their competitiveness. There is some evidence of Indian auto parts coming to Pakistan through indirect trade, i.e., via third countries, particularly the United Arab Emirates. Weak evidence also exists of trade being routed through Thailand and Singapore (Ahmed et al, 2013).

Table 6: Auto Parts Imports from India Compared with the Rest of the World (2013) – Chapter 84 of HS Classification

Product Code	Product Label	Pakistan's imports from India (000US\$)	Pakistan's imports from world (000US\$)	India's exports to world (000US\$)
845521	Hot or combination hot & cold metal rolling mills	1504	1880	7772
845590	Parts of metal rolling mills & rolls	228	772	77225
845530	Rolls for metal rolling mills	139	1883	39206
843149	Parts of cranes, work-trucks, shovels, and other construction machinery	135	27200	293987
840991	Parts for spark-ignition type engines	80	81302	270570
848210	Bearings, ball	36	30527	57694
840999	Parts for diesel and semi-diesel engines	35	59675	527760
848110	Valves, pressure reducing	14	34401	43641
848310	Transmission shafts and cranks, including cam shafts and crank shafts	9	18524	272344
841330	Fuel, lubricating or cooling medium pumps for internal comb piston engines	6	11366	104582
840890	Engines, diesel	3	8665	268935

Data Source: ITC Trade Map, 2014

¹⁰ Pakistan's imports and exports have been reported by Pakistan (ITC, Trade map).

5.2 *Automobiles as a part of negative and sensitive list¹¹ for India*

In order to protect local industry, Pakistan maintains a negative list for India consisting of 1209 products. Out of these 1209 products, 181 automobile products belongs to chapter 87 which accounts for 15 per cent of items on the negative list (India Pakistan Trade, 2013). By contrast, India has put only one item of automobile products ('tanks and other armoured fighting vehicles, motorised, whether or not fitted with weapons, and parts of such vehicle' HS code: 87100000) in the negative list, which it maintains for all trading partners.

Pakistan also maintains a sensitive list under SAFTA. The items included in this list are subject to non-concessional tariffs. Out of a total of 936 products (at HS 6 digit level) in the sensitive list, 69 are from chapter 87. Products under this chapter has also been listed in India's sensitive list. A duty of 8 per cent is imposed on auto parts imported by India; and in Pakistan the tariff rate ranges from 35 per cent to 60 per cent (Ahmed, 2013).

5.3 *Informal Trade in Automobiles*

Ahmed et al (2013) highlight a large amount of informal trade in automobiles between India and Pakistan. Around 10 retailers in Rawalpindi, 18 in Karachi, and 22 in Lahore dealing in informally traded Indian auto parts have reported a monthly turnover of US\$0.12, US\$0.25 and US\$0.1 million respectively. As per our estimates, these auto parts command a 30 per cent market share in Pakistan.

Various auto parts, especially gear boxes, are brought in Pakistan through the Wagah-Attari border. Dubai and the Afghan Transit Trade (ATT) route are also used to bring in Indian auto parts to Pakistan. Tyres, in particular, are informally traded through the ATT route and the annual turnover in tyres is around US\$243 million. Differentials and windscreens are other Indian products identified by the authors as being easily available in Pakistani automobile markets. This study also states that some of the Indian automobile products are of a better quality than Chinese products.

Moreover, informal trade in rickshaw/motorcycle parts, worth US\$5 million, takes place via the Dubai-Karachi route; while products valued at US\$250 million enter Pakistan via the Delhi-Lahore route (Khan et al, 2007). The authors highlight about 6 to 7 brands of Indian trucks and tractor tyres that are smuggled to Pakistan via the Chaman-Noshki border. Although the import of tyres from India is legal, tariff rates make these products expensive, making it more profitable for traders to import them through informal means.

¹¹ Negative list includes products that are restricted to be imported from India whereas the sensitive list includes the products which are allowed from India but are conditional on the application of certain tariff rates. These items in the sensitive list are also exempted from concessions on the tariff rates under SAFTA.

6. Price differential

The basic prices of various Indian and Pakistani cars are compared in Table 7. The variance in basic price arises out of the difference in taxes levied on consumers across the border. The ex-factory price of Pakistani cars includes a 17 per cent GST while that of Indian cars includes 12.5 per cent VAT and 3 per cent cess. The engine size has been used as a base to compare automobile prices in the two countries. The landed price of Indian cars after import by Pakistan under the current tariff regime is also given for comparison. The calculations to compute the landed cost of Indian cars are given in Annexure 1. Table 7 further highlights that the import of Indian cars at the prevailing Pakistani tariff rate will raise the prices of Indian cars in Pakistan.

Table 7: Prices of Selected Indian and Pakistani Cars (2014)

Model	Ex-factory Price (PKR)	Engine Size	Basic Price PKR: (Ex-Factory Price-17%GST)	Model	Ex-factory Price (INR)	Engine Size	Basic Price INR: (Ex-Factory Price-3% Cess-12.5% VAT)	Basic Price of Indian Car in PKR (Exchange rate: 1 INR=1.63 PKR)	Landed Price of Indian Car in Pakistan in PKR (Tariff rate*CIF+WHT)
Suzuki Mehran VX	625000	796cc	518750	Tata Nano Std BS III	152617	624 cc	128961	210207	348470
Suzuki Cultus VXR -Euro II	1044000	993 cc	866520	Hyundai Santro Xing (Non AC)	305543	1086 cc	258184	420840	794261
Suzuki Swift DX 1.3L	1221000	1328 cc	1013430	Tata Indigo eCS LS	540994	1396 cc	457140	745138	1437560
Suzuki Liana RXI (Petrol)	1465000	1328 cc	1215950						
Corolla XLI standard	1499000	1300 cc	1244170	Toyota Corolla Altis Diesel D4DJ	1300199	1364 cc	1098668	1790829	3424373
Corolla GLI	1729000	1600 cc	1435070	Toyota Etios J	555040	1496 cc	469009	764484	1474318
CRZ-hybrid	3269000	1496 cc	2713270						
Honda City Manual Transmission	1548000	1300 cc	1284840	Honda City i DTEC E	853000	1498 cc	720785	1174880	2254069
Honda Civic i-VTEC Manual	2051000	1800 cc	1702330	Honda CR V 2.0L 2WD MT	2089057	1997 cc	1765253	2877363	6184556
Camry A/T Up-Spec	10949000	2494 cc	9087670	Toyota Camry 2.5 G	2526540	2494 cc	2134926	3479930	7473480
Fortuner	5742000	2694 cc	4765860	Toyota Fortuner 4x2 Manual	2270435	2982 cc	1918518	3127184	6718937
CR-V 2.4 Litre	7900000	2354 cc	6557000						

Price data Source: Official Websites of Manufacturers/Assemblers and EDB (2014)

The following may be some other reasons for the price differential exhibited in the table above:

1. Pakistani auto manufacturers rely heavily on imported auto parts, which substantially increases the production cost, causing the price to rise.
2. The tax structure varies in the two countries and Indian manufacturers are paying greater taxes under excise duty, corporate tax, and education cess.

Analysis of car prices across the border reveals that small engine cars (engine size less than 1000cc) in India are substantially less costly than in Pakistan. There is potential for Tata Motors (India) to export low-cost cars to Pakistan if trade is liberalised. Similarly, cars with engine size greater than 2000cc are cheaper in India. It is likely that these cars would capture the local market for this segment because of their compliance with emission and safety standards, an area in which Pakistani cars are still lagging behind. On the other hand, the landed cost of Indian cars with engine size 1000-2000cc is far greater than the price of local cars in Pakistan. Hence, it is likely that the import of these cars might not be able to 'substitute' locally manufactured cars. One of the reasons for this price hike in landed cost of Indian cars may be high the customs duty imposed on import of cars in Pakistan.

7. Consumers as Stakeholders

Any stakeholder analysis centres around four aspects: stakeholder's position, their level of power to exert (policy) influence, their level of interest and the group they are associated with. This analysis is central to trade policy as well for two reasons. First, trade confers potential gains to both producers and consumers, and producer welfare is inseparable from consumer welfare (Chatterjee and George, 2012). Second, it is imperative to take account of the interests of each stakeholder (both primary and secondary) while formulating trade policy. In the case of bilateral automobile trade, the stakeholders generally identified in the literature are automobile manufacturers, auto parts vendors, auto-traders and the government. However, one group that is affected by changes in trade policies, and is often neglected, is that of consumers. While most research studies on trade do not consider consumers as primary stakeholders, we will particularly focus in this section on the gains to consumers.

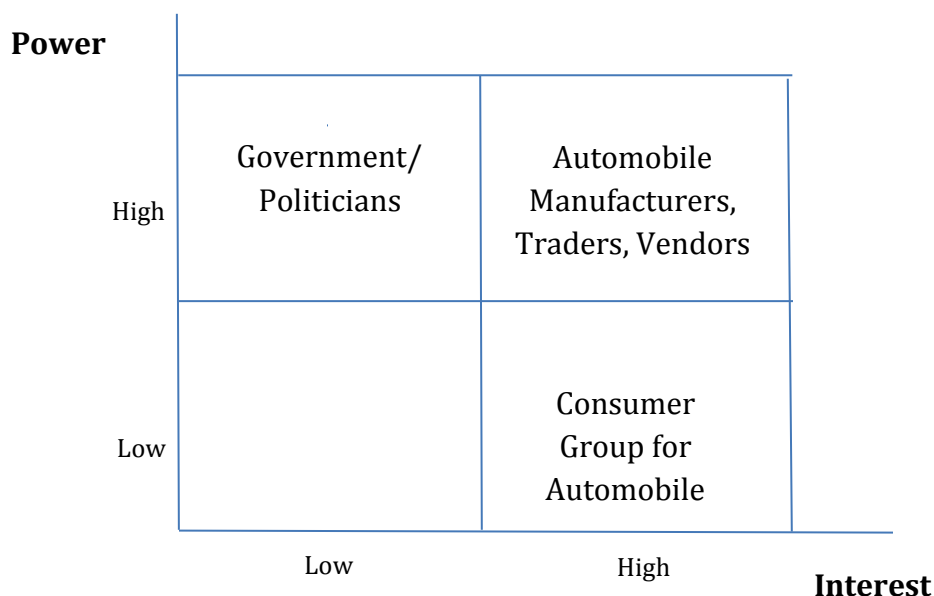
According to Chatterjee and George (2012), consumer welfare gains would be around US\$203 million for Pakistan if it trades with India while India would gain in terms of consumer welfare to the tune of approximately US\$545 million by trading with Pakistan in items currently being imported from rest of the world.¹²

The following power-interest matrix (Figure 8) can further elaborate the position of consumers with respect to trade policy. Consumers have a high interest in enhancing bilateral trade in automobiles but have little power to influence decision making; while auto manufacturers,

¹² These consumer welfare gains are calculated only for products in the sensitive list.

vendors and traders' groups have a vested interest as well as the power to influence policy. Hence, trade policy is usually supplier-centric. The government has power but it usually prioritises trade policy on the basis of the domestic political economy, foreign policy and security considerations. This is particularly true in the case of Pakistan's trade with India.

Figure 8: Power-Interest Matrix of Stakeholders for Bilateral Trade in Automobiles



The automobile industry continues to earn monopolistic profits due to excessive protection in Pakistan. With none or little competition, prices tend to rise and consumers end up paying high prices. Hence, there is potential for gain in consumer surplus through enhanced trade. With increased awareness of consumer rights, support for opening automobile trade with India is gaining strength. Consumers emphasise in particular the need to import small engine passenger cars from India. According to the Economist Intelligence Unit (2009), Pakistan is one of the expensive countries for automobiles (Table 8).

Table 8: Affordability ranking for Automobiles in Pakistan

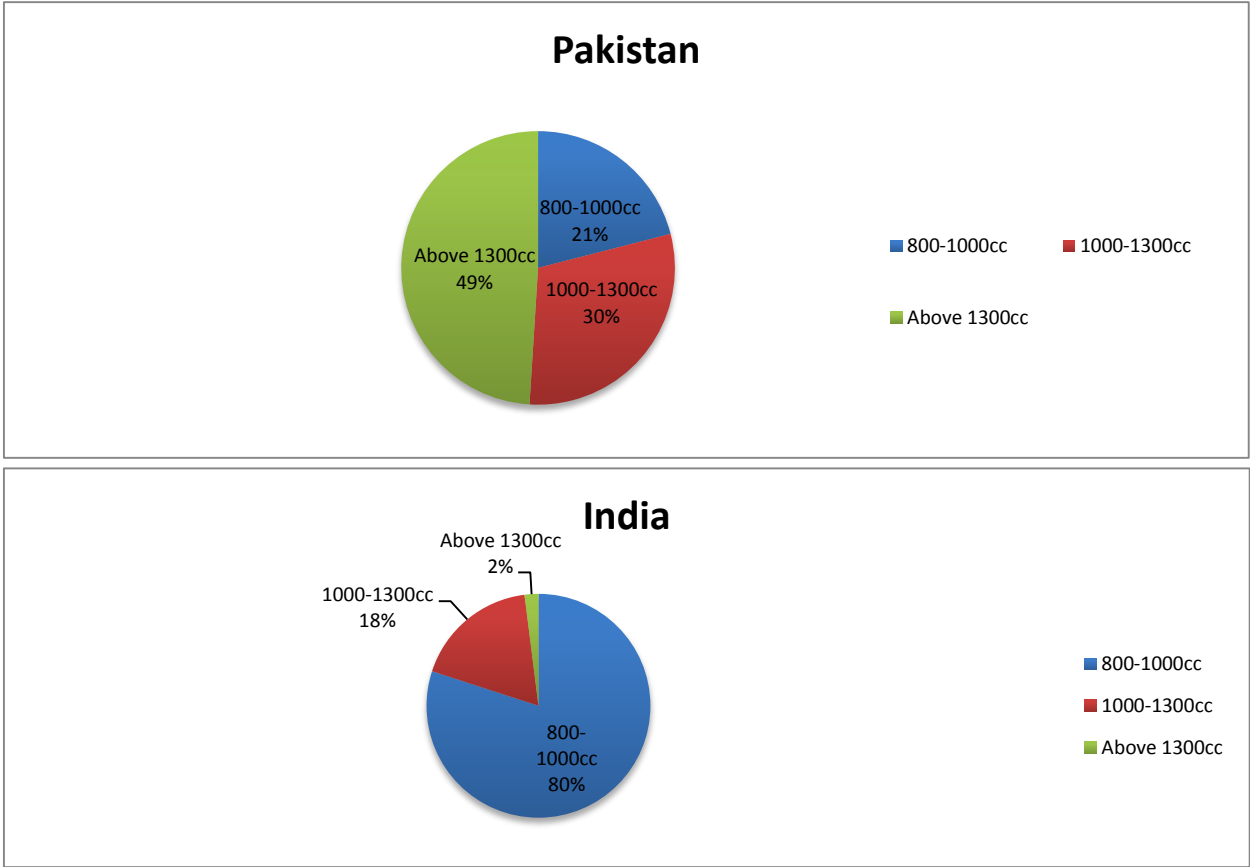
Item	Affordability rank ¹³
Low priced car, 900-1299cc (low)	55
Low priced car, 900-1299cc(high)	54
Compact car, 1300-1799cc (low)	57
Compact car, 1300-1799cc (high)	56
Family car, 1800cc-2499cc (low)	53
Family car, 1800cc-2499cc (high)	57

Source: Economist Intelligence Unit (2009) via CCP (2013)

¹³ Highest rank is 59, which shows extremely low affordability.

The middle-income group now forms the largest proportion in the country’s overall population structure (Nayab, 2011). High car prices have reduced the demand for automobiles by the middle-income group in Pakistan, resulting in a market that is skewed towards catering to the demands of elite. While there are commercial banks offering car financing schemes for low and middle income groups, the term structure of such hire purchase agreement has become harsher in the light of tightened prudential regulations by the Central Bank. Figure 9 compares the sales composition of passenger cars in Pakistan and India with respect to engine size. The elite models form a large part of the automobile market in Pakistan. This also explains why auto manufacturers in Pakistan focus more on the production and product development of large engine cars. India can provide cost effective, small engine cars to Pakistan as India focuses more on developing low-priced models.

Figure 9: Auto sale structure of India and Pakistan



Source: JICA, 2013

Consumers in Pakistan reportedly have a preference for used imported cars over locally manufactured cars. This is partly because of the better performance and safety features of imported cars. Automobile imports from India could increase competition and help improve the quality of locally manufactured cars. Some respondents also view Indian cars as more fuel efficient.

Given the unmet auto demand in Pakistan, consumers have to wait for delivery of cars for months. In some cases, the delivery could take as much 10-12 months. Importing from India is likely to reduce these time lags as well.

The entrance of new assemblers in the Pakistani auto industry in 2000 had increased employment opportunities. It is believed that liberalising automobile trade with India would generate a number of employment opportunities, at least in the long run. This applies to all three segments: manufacturing, vendor industries and the trading sector. Pakistan has liberalised the FDI regime for India, and going forward, Indian manufacturers may be invited to set up their own plants in Pakistan or enter into joint ventures.

The rapidly rising prices of automobiles have convinced consumer groups that trade liberalisation will bring down prices. Consumers realise that long-run positive gains would eventually make up for short-run negative effects (if any). Apart from this, consumers also view Indian automobile products as more environment friendly (based on their compliance with Euro-IV standards) and thus support their import. It is noteworthy that Pakistan has still not fully implemented Euro-II emission standards.

8. Quantitative Analysis

8.1 Product-Based Trade Complementarity Index (TCI)

Trade complementarity has been defined as how well import patterns of one country match the export patterns of another (Michaely, 1996). The higher the complementarity (near 100), the greater the likelihood of enhancing trade (WTO, 2012). We have modified the trade complementarity index (TCI) to determine product wise trade complementarity. Sectoral shares have been replaced with the share of individual products (at 6-digit level). Other specifications of the index remain the same.

TCI has been calculated only for Chapter 87 of the HS classification. The value of TCI (for Pakistan's automobile imports and Indian automobile exports for 2012) comes at 51.6, reflecting a medium degree of trade complementarity between the Indian and Pakistani automobile sectors. Pakistan imports a total of 70 automobile products (under the 6-digit category) from the world. India, on the other hand, exports 74 automobile products (at 6-digit) to the world with 70 common items with Pakistan. Thus, the potential for Pakistan to import from India does exist.

By contrast, the TCI (Chapter 87) for India's automobile imports and Pakistan's automobile exports stands at 38, signifying lower trade complementarity. However, such low complementarity might be the result of the different demand structures in the countries to which Pakistan exports (Upendra et al, 2012). This calls for enhancing Pakistan's export base in automobiles.

Literature also suggests that a close match of the import and export mix of the two countries provides a ground to enhance trade ‘without policy distortions or preferential trading agreements (Chow, 2012). But FTAs with a country of high complementarity is more likely to yield positive economic outcomes than trading with one with low trade complementarity (Schiff, 2001). Currently, India and Pakistan have FTAs and PTAs with other South Asian countries but no such bilateral trade agreement exists between the two neighbours.

8.2 *Bilateral Comparative Advantage of Pakistan and India in Auto Parts*

Bilateral Revealed Comparative Advantage (BRCA) is another widely used index in international trade and is based on Serin and Civan (2008). This index identifies the products of a country that enjoy a competitive edge as compared to other products.

We calculate this index based on data for the items in Chapter 84 ‘Machinery, Nuclear reactor, Boiler etc’ and Chapter 87, ‘Vehicles other than railway, tramway’ of the HS classification. The 6-digit level data has been selected for the computation of this index because it consists of both auto parts and CBUs. A total of 22 auto parts were identified from Chapter 84. Products with BRCA > 1 (i.e., products that have comparative advantage) have been shown in the Table 9 below.

Table 9: BRCA for Auto Parts and CBUs

Chapter code/ Countries	Products with BRCA >1
Auto Parts	
Chapter 84 (Pakistan)	Outboard motors, spark-ignition reciprocating or rotary type (840721), Air conditioners used in vehicles (841520)
Chapter 84 (India)	Parts of cranes, work-trucks, shovels and other construction machinery (843149), Oil or petrol-filters for internal combustion engines (842123), Transporter or bridge cranes (842619), Engines, diesel (840890), Parts of lifting, handling, loading or unloading machinery (843139), Parts for diesel and semi-diesel engines (840999), Hydraulic power engines & motors (841229), Parts of hydraulic & pneumatic & other power engines and motors (841290), Parts for spark-ignition type engines (840991), Transmission shafts and cranks, including cam shafts and crank shafts (848310), Engines, diesel, for the vehicles of Chapter 87 (840820), Bulldozers and angle dozers, crawler type (842911), Gears & gearing ball screws, gear boxes, speed changers/torque converters (848340), Moulds for rubber or plastics, (848079), Clutches and shaft couplings (including universal joints) (848360), Bearings, ball or roller, including combined ball/roller bearings (848280), Engines, spark-ignition reciprocating displacing > 250 cc to 1000 cc (840733), Engines, spark-ignition type (840790), Self-propelled works trucks (842720), Engines, spark-ignition reciprocating, displacing not more than 50 cc (840731)
Chapter 87	-none-

(Pakistan)	
Chapter 87 (India)	Motor vehicle parts (870899), Transmissions for motor vehicles (870840), Parts and accessories of bodies for motor vehicles (870829), Radiators for motor vehicles (870891), Bumpers and parts for motor vehicles (870810), Motorcycle parts (871419), Brakes and servo-brakes and their parts, for tractors and motor vehicles (870830), Bicycle wheel rims and spokes (871492), Wheels including parts and accessories for motor vehicles (870870), Safety seat belts for motor vehicles (870821), Bicycle parts (871499), Work truck parts (870990), Gas powered trucks with a GVW not exceeding five tonnes (870431), Steering wheels, steering columns and steering boxes for motor vehicles (870894), Drive axles with differential for motor vehicles (870850), Wheelbarrows, hand-carts, rickshaws and other hand propelled vehicles (871680), Trailer and other vehicle parts (871690), Bicycle frames and forks, and parts thereof (871491), Mufflers and exhaust pipes for motor vehicles (870892), Clutches and parts for motor vehicles (870893), Shock absorbers for motor vehicles (870880), Bodies for tractors, buses, trucks and special purpose vehicles (870790), Bicycle hubs and free-wheel sprocket wheels (871493), Bicycle brakes, including coaster braking hubs, and parts thereof (871494)
CBUs	
Chapter 87 (Pakistan)	Special purpose motor vehicles (870590), Road tractors for semi-trailers (truck tractors) (870120), Mobile cranes (870510), Trailers for the transport of goods (871639), Trailers for housing or camping (871610) Baby carriages and parts thereof (871500)
Chapter 87 (India)	Wheeled tractors (870190), Motorcycles with reciprocating piston engine displacing > 50 cc to 250 cc (871120), Bicycles and other cycles (including delivery tricycles), not motorised (871200), Diesel-powered buses with a seating capacity of > nine persons (870210), Automobiles with reciprocating piston engine displacing > 1500 cc to 3000 cc (870323), Buses with a seating capacity of more than nine persons (870290), Motorcycles with reciprocating piston engine displacing > 250 cc to 500 cc (871130), Automobiles with reciprocating piston engine displacing not more than 1000 cc (870321), Trailers for agricultural purposes (871620), Diesel powered trucks with a GVW exceeding five tonnes but not exceeding twenty tonnes (870422), Motorcycles with reciprocating piston engine displacing 50 cc or less (871110), , Motorcycles with reciprocating piston engine displacing > 500 cc to 800 cc (871140), Trailers and semi-trailers (871640), Automobiles with diesel engine displacing not more than 1500 cc (870331), Wheelchairs, mechanically propelled (871390), Pedestrian controlled tractors (870110), Motorcycles with other than a reciprocating piston engine (871190)

Data Source: ITC, Trade Map (2013)

While BRCA provides for enhanced trade in products with comparative advantage, the level of trade between Pakistan and India in products having comparative advantage is very low. With regard to comparative advantages in CBUs (Chapter 87), India has a comparative advantage in

17 CBUs. Pakistan does not import any CBU in which Pakistan has a comparative advantage. India also does not import any CBUs from Pakistan, wherein the latter has a comparative advantage in the case of 6 CBUs.

Pakistan does not have comparative advantage in any auto parts in Chapter 87. India, on the other hand, has a comparative advantage in the case of 24 auto parts. Within this category, Pakistan only imports 'motor vehicle parts' from India.

In Chapter 84, some auto parts were identified for the calculation of BRCA. Pakistan has comparative advantage in 2 auto parts but none out of these is imported by India. India, on the other hand, has a comparative advantage in 20 auto parts of the same chapter but Pakistan imports only 6 of these products from India.

9. Liberalising Auto Trade with India

Both Pakistan and India can benefit from liberalising bilateral trade in automobiles. For Pakistan, India offers a lucrative, large auto market. The Indian auto industry is expected to grow to US\$100 billion by 2020 (Foundry Review Magazine, 2013). Capturing even three to five per cent of this market would allow Pakistan to increase its automobile exports by almost US\$5 billion. Low freight cost, low prices for consumers, employment creation and the possibility of developing value-chains with India are some of the major benefits for the Pakistani auto industry. India on the other hand, can import tractors, motorcycles and auto parts from Pakistan. Pakistan is able to manufacture motorcycles (with smaller engines like 70 cc) at a much lower cost because it sources its inputs from China. Tractors are also priced much lower in Pakistan as compared to India and China (Ahmed, 2013).

9.1 Quality Comparisons

Auto manufacturers welcome the opening of automobile trade with India but with some reservations. They view Pakistani automobile products as being as competitive as Indian products. The Pakistani auto industry is well-equipped and is gaining a cost advantage in many products. Pakistan also maintains international standards in producing automobile products as a result of which Pakistan is able to export to various western markets. However, only those Indian automobile products that are manufactured in collaboration with foreign manufacturers have the best quality. Many auto importers based abroad (who earlier used to import from India) have pointed out that they are now importing from Pakistan because of quality issues with some Indian automobile items.

Auto importers point out that India produces automobile products of varying qualities. All high quality products are exported to foreign countries. Hence, there are concerns that opening of auto trade might result in the import of low quality products from India.

9.2 Indian Automobile Products as a Substitute

Indian products can be possible substitutes for Pakistan's automobile imports from the rest of the world. Pakistan would benefit from importing CKD items from India as it would help reduce the cost of production. Moreover, the policy of localisation had created problems for MNCs in the past. These MNCs are allowed to import auto parts only from their parent company. When the parent companies have to shift to some other country, as was the case of Pak Suzuki's Alto model, the production faced cut backs and ultimately, closure.

Pakistani auto manufacturers also fear that India is likely to gain more from liberalised trade in automobile products because of scale economies while Pakistan would not be able to increase its exports to India due to tariff and non-tariff barriers (including high environmental and safety standards). Hence, they advocate that Pakistan must negotiate the entry of its automobile products through a buy-back arrangement for value-added automobile products. Such an arrangement has been seen in the case of Argentina-Brazil auto trade (Ceravegna, 2003).

9.3 Pre-requisites for Opening Automobile Trade

Some preliminary steps that need to be taken before liberalising automobile trade, as highlighted by the representatives of PAMA and PAAPAM, are the following:

1. The government first needs to invest in increasing the capacity of local automobile manufactures in Pakistan before opening trade in automobile products with India.
2. Pakistan should consider 'technology transfer' from India as this would also allow Pakistani manufacturers to achieve low-cost productivity. This can also take the form of FDI by Indian auto manufacturers. FDI will increase production capacity and exportable surplus.
3. Quality assurance tests for vehicles are needed at the time of landing at Indian ports, which is a cumbersome process. Pakistan currently follows the EU quality standards for testing, whereas India demands testing to be performed as per Indian standards only. A common quality standard procedure needs to be devised in order to avoid unnecessary, extensive and repeated testing. Mutual recognition of standards between the two countries should be extended to the auto sector.
4. A stable duty structure needs to be put in place before opening up trade. A clear duty structure for a specified tenure may be agreed upon by both countries to avoid future

complications. Moreover, an agreement can be chalked out following the Mercosur agreement framework.¹⁴

5. The Indian government must ensure buy-back of a significant amount of the automobile products it exports to Pakistan in order to assure mutual gains. India can identify the automobile products to be imported from Pakistan. As indicated by PAAPAM, all auto exporters exporting to Pakistan import a large amount of Pakistani automobile products as well.
6. There are also concerns that Indian auto manufacturers are more interested in importing CKDs from Pakistan rather than CBUs.
7. Auto import policy with India should be focused on 'selective buying' from India. Products not manufactured in Pakistan should be given priority.
8. An essential step in liberalising automobile trade with India is the bridging of the communication gap between the auto manufacturers of the two countries. There is little or no interaction between the auto manufacturers of India and Pakistan, giving rise to apprehensions and doubts, for instance, of possible dumping of poor quality products by India in Pakistan. Overcoming the communication gaps through Track-II cross-border meetings of auto manufacturers is needed to push the process of liberalising trade in automobiles.

9.4 Apprehensions of the Manufacturing Sector

Pakistani manufacturers are of the view that their Indian counterparts enjoy large volumes of production (nearly 10 times larger than Pakistan). The highly technology-driven Indian auto industry has allowed auto manufacturers to produce automobiles at a very low cost, whereas Pakistan has to import necessary auto related raw material, which has led to higher production costs. This takes away the level playing field in bilateral automobile trade, placing the Pakistani auto-industry at a disadvantage. However, technology transfer from India can enable Pakistan to become self-sufficient in the supply of raw materials in the long run by enhancing the productive capacity of automobile manufacturers.

¹⁴ Mercosur is a trade bloc-based on a treaty signed by Argentina, Brazil, Paraguay, Uruguay and Venezuela to promote free trade. This was first signed by Argentina and Brazil. Under this treaty, automobile trade was quota based. For example, it was agreed that Brazil would export US\$265 worth of duty free automobile products to Argentina for every US\$100 of duty-free Argentine exports to Brazil. Each country negotiates annual bilateral import quotas for tariff free entry of automobiles. Economic conditions and the state of the auto industry in Argentina and Brazil resembled the current scenario of India and Pakistan and it proved to be a win-win situation for both countries (Ahmed, 2012).

They also feel that the removal of the negative list as a result of MFN status would result in the removal of Pakistan's sensitive list vis-à-vis India under SAFTA. This would ensure duty free access to Indian automobile products, which would wipe out Pakistani products. However, if only the negative list is to be removed, Indian products would be subjected to the same duty as imposed on Japanese products, which would thus eliminate the potential threat to the Pakistani auto industry.

While this view of Pakistani industry being driven out of the market as a result of trade liberalisation with India is often highlighted, Gopalan et al (2013) present another optimistic dimension. They assert that the FTA with China signed in 2006 has not 'wiped out' a single auto manufacturer in Pakistan, despite China having a highly competitive industry. In fact, this initiative has allowed greater benefit to consumers and helped promote competition among Pakistani auto parts manufacturers.

9.5 Tariff barriers facing Pakistan's Two-Wheeler Exports

According to a representative of the Trade Development Authority of Pakistan, Pakistani two-wheelers in particular are subject to high tariff rates. Figure 10 shows that the freight cost works out to 34 per cent of the total cost of export of two-wheelers to India. The table excludes other additional charges such as port expenses (almost 3 per cent) and incidental costs of clearance (2 per cent of the cost, insurance and freight value). Even if custom duty is removed, other taxes account for duties of over 25 per cent. Export costs would rise further if one takes into account the excluded cost of approvals, permissions and certifications. This makes the export of two wheelers to India nearly impossible. In Figure 11, we compare India's and Pakistan's tariff structures to that of some other select countries producing two-wheelers.

Figure 10: Import Duty Calculator for Motorcycles (Units)

Import Duty Calculator of Motor-cycles		
Enter Value	100	Calculate Duty
<input checked="" type="radio"/> CIF Value <input type="radio"/> Assess Value		
Formula	Duty Rates	Duty Amount
Assessable Value – (A) (CIF Value + 1% Landing Charge of CIF)		(A) 101.00
Basic Duty – (B) (A) x Basic Duty Rate	100.00%	(B) 101.00
Preferential Duty – (B) (A) x Pref. Duty Rate	0	(B) 0.00
CVD: Additional Duty – (C) (A+B) x CVD Rate	10%	(C) 20.20
Central Excise Edu Cess – (D) (C) x Central Excise Edu Cess rate	3 %	(D) 0.61
Customs Education Cess – (E) (B+C+D) x Customs Edu. Cess rate	3 %	(E) 3.65
Special CVD – Special Duty – (F) (A+B+C+D+E) x Spl. CVD rate	4%	(F) 9.06
Total Custom Duty	(A+B+C+D+E+F)	134.52

Source: TDAP (2012)

Figure 11: Comparison of Tariff structure (Two Wheelers) of India and Pakistan with other Countries

Year	CBU Tariff	CKD Tariff	Excise Duty/ Withholding Tax	VAT	Corporate tax rate	Interior tax	Additional duty of customs to countervail local taxes (SPL)	Countervailing duty (CVD)	Educational cess (EDU)	National calamity contingent duty (NCD)
Pakistan	65%	15%	3% / 5%	16%	35%					
India	100%	10%	10%	12.5%	34.0%		4%	16%	3%	1%
Malaysia	30%	0% to 10%	20% to 50%	10%	25%					
Indonesia <i>For 50cc - 250cc</i>	35%	0%		10%	25%					
Indonesia <i>For 250cc to 500cc</i>	150%	0%								
Thailand	60%	0%	35%	7%	30%	10% of excise tax				
Vietnam	100%	0% to 5%		5% ~ 10%	25%					

Thai Excise tax = (CIF value + import duty) * {Rate of excise tax / (1 - (1.1 * Rate of excise tax))}
 = (100+80) * {0.35 / (1 - (1.1 * 0.35))}
 = 180 * 0.5691057

Source: Prepared by authors in consultation with TDAP

9.6 NTBs Facing Pakistan's Automobile Exports

According to PAAPAM representatives, some of the taxes imposed by the Indian customs department at the border and ports are not stated officially and are imposed arbitrarily at

the discretion of the on-duty official. Moreover, Pakistani automobile exports to India are also subjected to state-specific levies, which are not explicitly documented.

The lack of fork lifters needed to unload the consignment at the Wagah border is also a setback as it increases the likelihood of damaging the product even before it reaches its destination. The Indian government also recognises the low handling capacity of their ports but no action has yet been taken to resolve these issues.

India has adopted strict policies with regard to the import of two-wheelers from Pakistan. Homologation¹⁵ certificate is needed for the export of bikes to India, which is a time-consuming process (it takes at least 6 months) and involves excessive red tapism (FPCCI, 2011; Ahmed et al., 2013). The TDAP, however, claims that the time taken is much longer (more than 9 months) for obtaining the homologation certificate. According to TDAP, problems related to homologation have been faced even by EU auto exporters. BMW has reportedly paid €200,000 for obtaining homologation certificate for the export of their model 'minor'. Even after paying the fee, they had to face extensive delays due to complex bureaucratic procedures. Apart from two-wheelers, this certification is also needed for the export of tractors. Pakistani tractors fail to enter Indian markets due the lack of this certification.

Another representative from the public sector contended that Indian emission standards are set too high for two-wheelers, as compared to those of EU and Japan. India requires automobile products to comply with Bharat-II and Bharat-III standards of emission. These standards are different from the international standards, which acts as a barrier to imports. Several think tanks and consumer groups in Pakistan remain of the opinion that better emission standards set by India should be viewed as an opportunity by Pakistan to improve its environmental standards. This will enhance the chances of Pakistan's exports reaching not just India, but other countries as well.

10. Way forward

The recent Track-I cross border meetings on trade liberalisation is a welcome step. The opening of markets for Indian exporters and investors will boost economic activity in Pakistan and vice versa. In the case of automobiles, there exists substantial potential for bilateral trade that needs to be exploited. In order to liberalise automobile trade with India, a disaggregated, product-based approach may be adopted. The following institutions can play a critical role in this process.

The Ministry of Commerce can negotiate a uniform tariff across the border. For example, both India and Pakistan can allow the import/export of locally manufactured cars at a similar tariff rate. It will ensure mutual gains for auto manufacturers in both countries. Tariff structures should be properly documented in order to avoid any disguised tariffs. Similarly, tariff on the import of

¹⁵ Certification required to confirm that a product meets a specific standard

raw materials from India should be reduced to enable local manufacturers to produce cost-effective automobiles.

Commerce ministry can also collaborate with the National Tariff Commission (NTC) to simplify the tariff structure. MoC and NTC may eliminate items (especially auto parts) from the negative list for India and the 'no concession list' for China. Both countries can then compete with each other in the Pakistani automotive market.

The Ministry of Industries, more specifically the EDB, can establish automotive testing labs to ensure that only accredited products enter the Pakistani auto market from India. Such labs should in no manner act as a barrier to trade. Timely testing must also be ensured. This can also be done in collaboration with PSQCA. Moreover, these testing facilities should be standardised across the border.

The Board of Investment may reassess investment policies for the promotion of competition in the automobile industry. Liberalised policies are needed to foster a competitive environment in this industry. High localisation requirements are a deterrent to foreign investment and hence, must be relaxed.

In order to fully benefit from the supply chain potential in this sector, the State Bank of Pakistan can collaborate with the Reserve Bank of India to facilitate cross-border investment through banking channels and opening up of bank branches. This step is also important for enhancing bilateral trade in intermediate inputs.

The Ministry of Interior may work towards a relaxed visa regime for easy cross-border exchange of technical personnel. The ministry can also establish control cells on the borders to keep a check on informally traded products. Apart from this, PAMA can help devising a mechanism to check informal import of automobile products. PAMA can also collaborate with ACMA to negotiate trade terms to ensure mutual gain.

Automobile manufacturers on both sides of the border should take steps to overcome the communication gap. Bilateral Track-II meetings can help build the confidence of manufacturers and reduce apprehensions of auto manufacturers on both sides of the border. Moreover, bilateral meetings would encourage investors in India to invest in their counterparts in Pakistan. MoC can also help in facilitating these bilateral meetings.

Auto manufacturers, the Ministry of Environment, and the Hydrocarbon Development Institute of Pakistan can collaborate to upgrade emission standards for automobiles in Pakistan. Initially, the import of Euro III standard engine parts can be allowed duty free access to Pakistan to support the production process of automobiles. Importing these parts from India can help produce low-cost, environment friendly vehicles.

The Consumer Rights Commission of Pakistan can also collaborate with research think tanks to investigate consumer gains by liberalising trade and investment in the auto sector.

Lastly, the governments of Pakistan and India should focus on confidence building measures. Both sides should ensure that trade is not affected by political setbacks. Government of Pakistan should invest in the capacity development of local manufacturers. The Small and Medium Enterprise Development Authority (SMEDA) can play an important role in enhancing the productive capacity of auto parts manufacturers by extending financial and technical support.

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ANNEXURE

Annexure 1: Calculation of Landed Cost of Indian Cars

Car model and price in Pakistan			Car model and price in India			Calculation of Landed Cost of Selected Indian Cars							
Model	Ex-factory price (PKR)	Engine Size	Model	Ex-factory price (Indian rupee)	Engine Size	Price in PKR Exchange rate (1 INR=1.63 PKR)	Freight cost \$400 Exchange rate: 1\$=98.10	Insurance 1%	(CIF= Freight + Insurance) (PKR)	Tariff rate	Tariff rate *CIF	WHT (5%)	Landed Price of Indian Car PKR (Tariff rate*CIF+WHT)
Suzuki Mehran VX	625,000	796cc	Tata Nano Std BSIII	152617	624 cc	248766	39240	2880	290886	30%	87266	12438	348470
Suzuki Cultus VXR -Euro II	1,044,000	993 cc	Hyundai Santro Xing (Non AC)	305543	1086 cc	498035	39240	5373	542648	50%	271324	24902	794261
Suzuki Swift RS DX 1.3L	1,221,000	1328 cc	Tata Indigo eCS LS	540994	1396 cc	881820	39240	9211	930271	55%	511649	44091	1437560
Suzuki Liana RXI (Petrol)	1,465,000	1328 cc											
Corolla XLI standard	1,499,000	1300 cc	Toyota Corolla Altis Diesel D4DJ	1300199	1364 cc	2119324	39240	21586	2180150	55%	1199083	105966	3424373
Corolla GLI	1,729,000	1600 cc	Toyota Etios J	555040	1496 cc	904715	39240	9440	953395	55%	524367	45236	1474318
CRZ-hybrid	3,269,000	1496 cc											
Honda City Manual Transmission	1,548,000	1300 cc	Honda City i DTec E	853000	1498 cc	1390390	39240	14296	1443926	55%	794159	69520	2254069
Honda Civic i-VTEC Manual	2051000	1800 cc	Honda CR V 2.0L 2WD MT	2089057	1997 cc	3405163	39240	34444	3478847	75%	2609135	170258	6184556
Camry A/T Up-Spec	10,949,000	2494 cc	Toyota Camry 2.5 G	2526540	2494 cc	4118260	39240	41575	4199075	75%	3149306	205913	7473480
Fortuner	5,742,000	2694 cc	Toyota Fortuner 4x2 Manual	2270435	2982 cc	3700809	39240	37400	3777450	75%	2833087	185040	6718937
CR-V 2.4 Litre	7,900,000	2354 cc											

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