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## India - Pakistan trade: Textiles and clothing

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# **Working Paper 326**

## **India – Pakistan Trade: Textiles and Clothing**

**Nisha Taneja**

**Saon Ray**

**Devyani Pande**

**June 2016**



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## Abstract

India and Pakistan are the leading textile trading nations in the world. Among the major sectors, the textile and clothing sector accounts for the largest share in trade between India and Pakistan chiefly because of the similarities in culture and the importance of the sector in their economies. However, the level of bilateral trade in textile and clothing at USD 722 million (2013) is dismal as compared to the trade potential of USD 2.10 billion. To make a case for increasing trade in this sector, this study analyses the reasons for low levels of trade, the nature of trade in this sector and the intra-industry trade between the countries. The textile and clothing items account for 5.7 percent of the items in Pakistan's negative list and 25 percent in the sensitive lists of both countries. Moreover, the figures for value of imports subject to higher tariffs by way of being in India's sensitive list are much higher than that for Pakistan.

Bilateral trade is more pronounced in textiles rather than clothing, and cotton yarn is the most traded textile item. Despite that, there is a high level of intra-industry trade in clothing and apparels. This reflects complementarities in trade in textiles and clothing between the two countries. An insight into the type of intra-industry trade points that trade is mostly concentrated in items that need processing and differ in quality. Indian exports are most likely to be high-quality processed exports. A survey among stakeholders validated the findings that India produces better quality fabric and is more competitive in the manmade fibres segment. On the other hand, Pakistan has a competitive edge in the production of cotton.

The study also throws light on the informal trade in textiles between the countries and views from industry stakeholders, thereby suggesting removal of the negative list by Pakistan and sensitive list by India that hinder bilateral trade. The nature of trade in the sector also brings out the potential to integrate in supply chains. In the South Asian region, both countries could join hands with Bangladesh and Sri Lanka to liberalize trade in items that the countries import from outside the region.

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**Key words:** Trade, textiles, clothing, India Pakistan,

**JEL Classification:** F10, F13, F14

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# India – Pakistan Trade: Textiles and Clothing<sup>1</sup>

Nisha Taneja, Saon Ray and Devyani Pande

## 1. Introduction

The textiles and clothing (T&C) sector has been one of the most prominent manufacturing sectors of South Asia in terms of its contribution to output, employment and trade. The share of the region's trade in textiles and clothing with the world increased from 2% to 8% over the period 2007-14 (WITS database). Needless to say, textiles have played an important role in the social, cultural, and economic life of South Asia. In the recent times, the two South Asian giants—India and Pakistan have emerged as the leading textile trading nations in the global trade scenario. Both countries remain strongly interrelated and interconnected with each other through similar culture, language, dress, climate and traditions, which bond them together despite the diplomatic differences (Mohmand and Naqvi, 2012). Given the similarities in dressing and fashion, potential for trade between the two countries in clothing items such as salwar kameez dupatta (SKD), bridal wear and dresses is immense. Many Pakistani textile firms have made efforts to collaborate with their Indian counterparts to market their products in India. In addition, the setting up of the Pakistan Fashion Design Council (PFDC) in 2012 in New Delhi that showcases designer-wear from Pakistan affirms the potential for traders from across the border to cater to the demand for apparel and clothing. From the Indian side, the opening of “The Raymond Shop”, an Indian suitings and fabrics showroom in Karachi in 2013 was another positive step for trade and investment in textiles between the countries.

However, India and Pakistan have had their share of ups and downs that had a bearing on trade between them. Tracing back the relations between the countries to the previous decade, the December 2001 attack on the Indian Parliament, Samjhauta Express blast in 2007 and the Mumbai attacks in 2008 were the times of discord between the countries, apart from the diplomatic differences that have ensued over the years. On the trade front, India granted the MFN (Most Favoured Nation) status to Pakistan in 1996, which is yet to be reciprocated by Pakistan. The two countries came together as trade partners in 2006 by signing the South Asian Free Trade Area (SAFTA) Agreement<sup>2</sup>. During this time till 2012, Pakistan maintained a positive list that allowed only 767 items to be imported from India. Adhering to a Joint Statement between the two nations, it made a transition from the positive list approach to a more trade enabling, small negative list of 1,209 items in March 2012. However, it continued to restrict road-based trade by allowing only 137 items to be imported from India via road (Taneja et. al, 2013). Following the shift to a negative list, the focus of the trade negotiation has shifted to Pakistan granting the NDMA (Non-discriminatory market access)<sup>3</sup> status to India. This will entail termination of the negative list and lead to further liberalization of trade

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<sup>1</sup> The survey for the study was carried out by Mishita Mehra and Prithvijit Mukherjee.

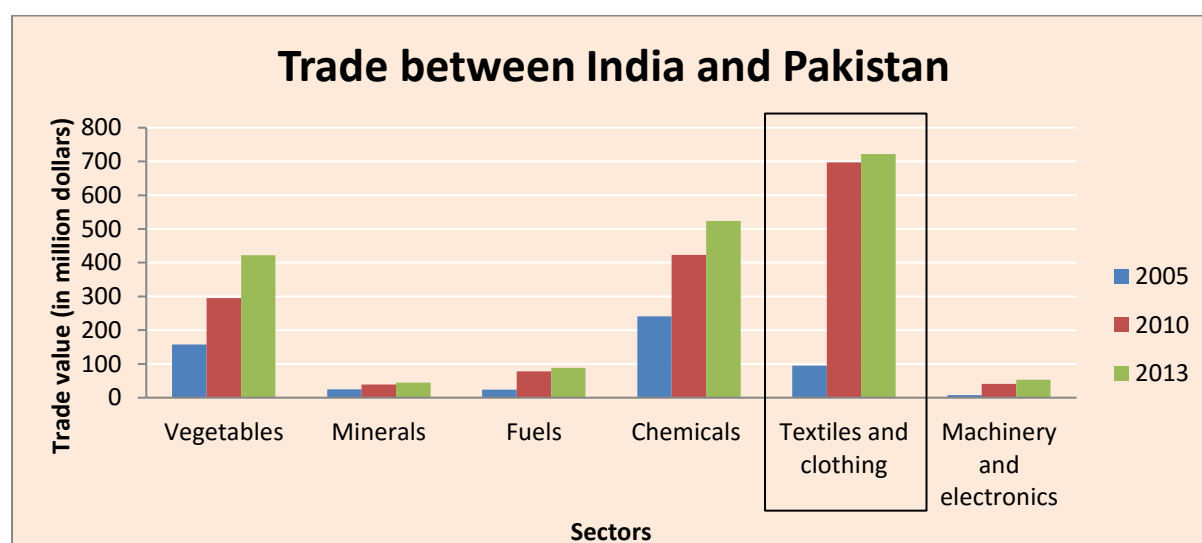
<sup>2</sup> SAFTA is the South Asian Free Trade Area Agreement comprising of India, Pakistan and Sri Lanka as the non least developing countries (NLDCs) and Bangladesh, Nepal, Bhutan, Afghanistan and Maldives as the least developing countries (LDCs).

<sup>3</sup> The NDMA status is the same as the Most-favoured Nation (MFN) status. The change in terminology was made to avoid political ramifications.

between the countries. There have been a series of discussions between the governments with regard to grant of the NDMA to India but the agreement has not yet materialized. Perhaps the apprehension of the traders regarding the influx of imports from India and the resulting increase in trade imbalance along with political issues are the main reasons, which have led to a delay in the grant of NDMA from the Pakistani side. The agricultural lobbyists and textile traders themselves are skeptical of opening the Pakistani market for India citing loss of employment and weakening of the domestic textile sector. This paper seeks to make a case for enhancing bilateral trade between India and Pakistan in the textile sector owing to the similarities in culture and clothing. Apart from the existing similarities between the two countries, the textile and clothing (T&C) industry occupies a unique position in the economies of both India and Pakistan in terms of its contribution to industrial production, employment and exports. The proliferation of international production and distribution networks spanning across borders is presenting developing countries with both new economic development opportunities and challenges. Participation in these production and distribution networks is an important way to attract investment, increase technological capability, build industrial capacity, and foster economic growth (WTO/OECD/IDE-JETRO, 2013). Harnessing this potential by enhancing bilateral trade in textile sector will go a long way in improving relations between the two countries. The importance of this sector in integrating the economies of India and Pakistan can be ascertained by a sector-wise comparison of bilateral trade between the countries.

A snapshot of the sector-wise trade between the two countries over the period 2005-13 shows that vegetables, chemicals and textile & clothing are the major sectors of bilateral trade. This sectoral trade between India and Pakistan has undergone major changes over the period 2005-2013.

**Figure 1: Total Trade between India and Pakistan in the major sectors (2005, 2010 and 2013)**



*Source:* Based on data from UN COMTRADE

Initially, bilateral trade in textiles and clothing was very small, third largest, after chemicals and vegetables. However, the period 2005-2010 saw an uptick in the total trade in textiles recording the largest CAGR of 49% among the major sectors of trade between India and Pakistan. At present, the textiles and clothing sector accounts for the largest proportion of trade between the countries. The rise in T&C trade from the year 2005 to 2010 is noteworthy. This can be attributed to the trade liberalization programme under SAFTA. The trade liberalization programme entailed tariff reduction by Non-Least Developed Contracting States (NLDCs)<sup>4</sup> from 20% or below to 0-5% within a time frame of 5 years, beginning from the third year from the date of coming into force of the Agreement. The total trade in other sectors has increased, but none of them has shown such a meteoric rise as that of the T&C sector over the years.

With this backdrop, we look at the pattern of trade within this sector and try to gauge the potential for T&C trade between India and Pakistan by qualitative and quantitative analysis. Section 2 explains the objectives of the study through a short discussion on the structure of the T&C sector and research questions. Section 3 presents the evolution of the T&C sector in India and Pakistan. This will provide an insight into the development of the textile policies and regulations in the countries over the years. Section 4 gives an overview of the current trade of T&C and its trade potential, the nature of textile trade and the items in the negative and sensitive lists. Section 5 presents the results of the quantitative analysis. We discuss the intra-industry trade indices and the type of intra-industry trade taking place in the T&C sector. Section 6 presents the findings from surveys with traders and stakeholders of the textile sectors on both sides and a brief discussion on informal trade. Section 7 concludes the research findings by providing recommendations for enhancing India-Pakistan trade in T&C.

## **2. Objectives of the Study**

The importance of textiles and clothing in the global trade scenario is well documented in literature. Most developed countries of today and newly industrialized countries (NICs) used this industry as the springboard for their development journey and even some least developed countries (LDCs) were able to step onto the development ladder on the basis of their T&C industry (Adhikari and Yamamoto, 2008). The T&C is a peculiar sector that has witnessed a remarkable evolution in structure and nature over the years.

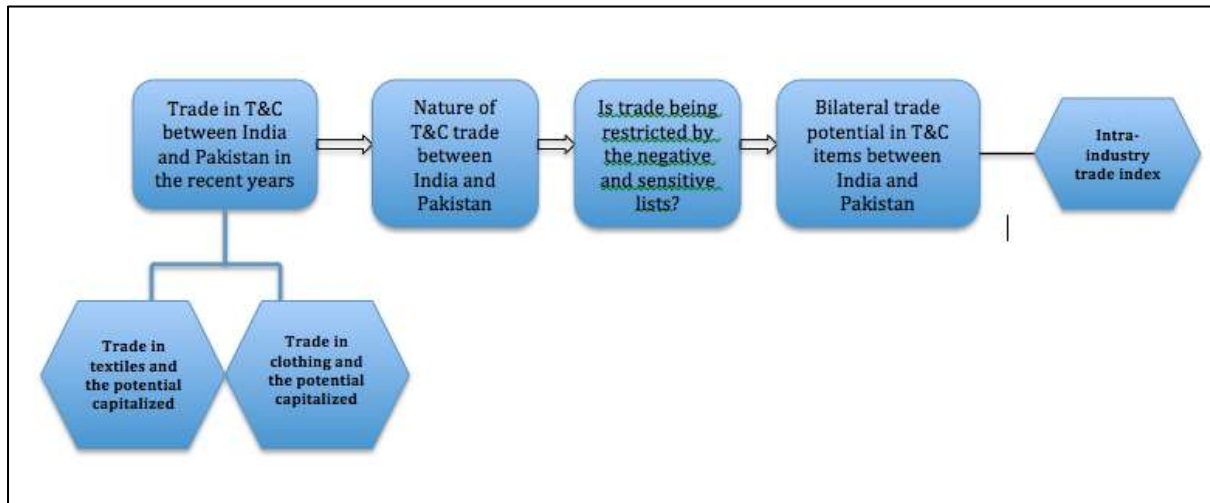
Textiles and clothing are closely related both technologically and in terms of trade policy. Textiles provide the major input to the clothing industry, creating vertical linkages between the two sectors (Nordas, 2004). At the micro level, the two sectors are increasingly integrated through vertical supply chains that also involve distribution and sales activities. They can be seen as a supply chain consisting of a number of discrete activities. The clothing industry is labour-intensive industry where relatively modern technology can be adopted. The textile industry is usually more capital intensive than the clothing industry and it is highly automated,

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<sup>4</sup> SAFTA is the South Asian Free Trade Agreement comprising of India, Pakistan and Sri Lanka (as the NLDCs) and Bangladesh, Nepal, Bhutan, Afghanistan and Maldives as the least developing countries (LDCs).

particularly in developed countries. It consists of spinning, weaving and finishing, and the three functions are often undertaken in integrated plants.

**Figure 2: Analytical Framework**



The main aim of the research undertaken is to track the various aspects of trade in T&C between India and Pakistan over the years and determine the potential for bilateral trade in this sector. For this, we try to answer the following questions:

- How has the T&C sector evolved in India and Pakistan?
- What has been the pattern of bilateral trade in T&C between India and Pakistan and how important is this sector for the two countries with respect to their trade with the world?
- What has been the individual contribution of the textiles and clothing segments to trade in the T&C sector? What is the trade potential for both countries in this sector and how much of the trade potential has been capitalized? In what way does the maintenance of the negative and sensitive lists restrict the trade in T&C between the countries?
- What has been the nature of trade in T&C between India and Pakistan? What is the extent of intra-industry trade in the T&C sector between India and Pakistan? How do firms perceive trade complementarities in this sector?

To gauge the trade potential in this sector, we have calculated the intra-industry trade (IIT) indices in T&C items of each of the countries. Since the trade in T&C sector has both vertical and horizontal linkages, we have also looked at the components of IIT viz. vertical and horizontal IIT. The results of these quantitative exercises will also help in demonstrating the trade complementarities that exist in the T&C sectors between India and Pakistan. The trade figures have been extracted from UN COMTRADE and we have made use of the TradeSift software for calculation of intra-industry trade indices.



### **3. Evolution and structure of the Textile Sectors in India and Pakistan**

The phasing out of the Multi-fibre Agreement (MFA) and the WTO agreement on Textiles and Clothing were possibly the major global trade policy changes that impacted the T&C sectors, especially cotton, of both India and Pakistan. The MFA was a trade agreement adopted in 1973 by the United States, Canada, and Europe that set quotas for the amount of textiles and apparel that other countries could export to these countries. It came into force in 1974, and was seen as a protectionist measure intended to prevent the loss of textile and garment industry jobs in the developed countries from mainly developing countries, where such goods could be more cheaply produced (Economic Review, 2005). After many rounds of renewal, it was in 1991 as part of GATT's (General Agreement on Tariffs and Trade) Uruguay Round trade negotiations that a definitive plan known as the Agreement on Textiles and Clothing (ATC) was laid down for phasing out of the quantitative restrictions. The ATC set a four-stage liberalization schedule with 2005 being the final year of full integration into GATT (elimination of quotas and termination of the ATC). Post the MFA, India and Pakistan have been the biggest gainers in terms of their growth in textile exports along with China (The Dawn, 2005). The increase in trade post MFA, over the period 2007-13 for India, China and Pakistan was 119%, 49% and 44% respectively (WITS database). In addition to this, the various domestic reforms undertaken in India and Pakistan have also given a push to the T&C sector of India and Pakistan.

The textile policies of both India and Pakistan clearly point to the importance of the sector in their respective economies. According to the Textile Policy of Pakistan (2014-19), textiles is the most important manufacturing sector of Pakistan and has the longest production chain, with inherent potential for value addition at each stage of processing, from cotton to ginning, spinning, fabric, dyeing and finishing, made-ups and garments. The sector contributes nearly one-fourth of industrial value-added, provides employment to about 40% of industrial labour force, consumes about 40% of banking credit and accounts for 8% of GDP. Textiles are the mainstay of the exports of Pakistan accounting for 53% of its total world exports. Pakistan is the 4<sup>th</sup> largest producer and 3<sup>rd</sup> largest consumer of cotton in the world (Textile Policy 2014-19, Ministry of Textile Industry, Government of Pakistan).

The textile industry in India traditionally, after agriculture, is the only industry that has generated huge employment for both skilled and unskilled labor in textiles. It continues to be the second largest employment generating sector in India. The potential size of the Indian textiles and apparel industry is expected to reach USD 223 billion by 2021, according to a report by Technopak Advisors. The Textiles Vision Document formulated by the National Manufacturing Competitiveness Council (NMCC) has projected that textiles exports from India will touch USD 300 billion by the year 2024-25.

In both India and Pakistan, the textile and apparel sectors exhibit different degrees of specialization. Firms in Pakistan specialize in cotton textile intermediate goods (yarn and grey fabric), as well as towels and bed linen. Firms in India have developed a highly complex sector covering the entire value and production chain from fibre production to garment manufacture

and packaging (Rasheed T., 2012). We discuss the evolution and structure of the textiles industry in India and Pakistan in this section, which has contributed to the growth of the industry in each country.

### **3.1 India**

The size of India's textile and apparel industry is estimated at USD 94 billion in 2012. Out of this domestic industry constitutes of USD 63 billion and exports are worth USD 31 billion (FICCI, 2013). India has an overwhelming presence in textiles from fibre to garments and the sector's importance in the economy can be seen from its contribution to GDP, industrial production, export earnings and employment (*ibid*). India is the second largest textile and apparel exporter in the world. Textiles and apparel exports from India are expected to grow at a CAGR of 9% over the next decade. The rate of growth of apparel exports will continue to be higher than that of textiles. The top textile and clothing export partners of India in 2013 were China, the US, Bangladesh and UAE (Presentation on Global & Indian Textile & Apparel Trade Background Information, Technopak, 2014).

The Industrialisation Policy enacted in 1948, right after independence laid down the priority areas and regulations for the development of industries. Post this, till the late 1980's, the textiles industry remained one of the most restricted industries due to the regulations and policies to ensure that mechanization did not occur, labour intensive textiles were produced and large scale production was discouraged by restrictions on total capacity. The production of all textile mills was controlled as was the maximum number of counts of yarn, and the width of the cloth to be produced for products like dhotis and saris. It was also a common practice to reserve the production of some product lines such as towels, for small-scale firms (Bedi, 2008). The imposition of quotas on yarn exports, stringent licensing for organized sector and price regulations to handle the shortages resulting from the licensing restrictions were the other barriers to the growth of the sector in India during this period.

It was only in 1991, with the ushering in of the reforms and the New Industrial Policy that the textile industry was removed from the licensing category. The Statement of Industrial Policy 1991 and the Textile Development and Regulation Order of 1992 brought about reduction in controls to bring about greater transparency. In the later years, the National Textiles Policy, 2000 redefined the goals and objectives in tune with the times to develop a strong and vibrant industry. The policy laid down targets and outputs for all segments of the textiles and clothing industry like cotton textiles, silk textiles, jute textiles, man-made fibres, made up textiles etc. It emphasized the crucial role of exports of textile items. The Policy also laid down the objective of increasing exports to USD 50 billion by 2010 from the then present level of USD 11 billion.

Other major reforms in the policy were: inducing technological development in the value-added stages of processing, including (1) Development of export zones and technology parks to encourage economies of scale through government support by exempting firms from labor regulations and providing them with concessions on land purchases, credit, and taxes (2)

Removal of foreign direct investment constraints (3) Reforms in labor regulations that allow splitting of units into several smaller units to avoid complications in laying off workers and in availing tax incentives (4) Launching the Technology Upgradation Fund Scheme (TUFS) to encourage technological improvement through incentives. The total inflow of foreign direct investment (FDI) in all sectors improved in response to the economic reforms, but FDI remained small relative to domestic investment. Moreover, since 1991, the textiles sector has accounted for only about 1 percent of FDI inflows to India (Economic Survey, Government of India, 2004). Indian labor policies were cited by several Indian companies as the principal constraint on firm size, industry investment and international competitiveness. The labor reform benefited particularly those units operating in export zones. The open-ended scheme depended on the capacity of the industry to absorb funds in bankable and the 5 percent interest reimbursement of the normal interest charged by lending agencies (5) Sponsorship of various Technology Missions on Cotton (TMC), which seek to address the issues of integrating the different aspects of cotton, such as research, extension and development for production, development of market infrastructure/yards, and modernization of ginning/pressing factories.

The change in the domestic policy environment along with phasing out of the global Multi-fibre Agreement (MFA) under the WTO created tremendous opportunities for the textiles and apparel sectors in India. In the international scenario, India is regarded as a major alternative source to China after the quotas were removed for textiles and made-up articles. It has inherent strengths in terms of a strong multi-fibre raw material base, low cost of labour, intellectual capital and dynamic entrepreneurship.

### ***3.2 Pakistan***

Pakistan's textile industry provides 9% of the global textile needs and is ranked at 10<sup>th</sup> among the world textile producers. The textile industry, based on locally grown cotton, produces mainly cotton yarn, cotton cloth, and made-up textiles and apparel. Market for imported textile machinery and equipment in Pakistan is directly proportional to the overall strength of the local textile industry (Kazmi, S.A.Z. and Takala, J., 2014). The top textile and clothing export partners of Pakistan in 2013 were the US, China, UK, Germany and Bangladesh (International Trade Map).

Industrialization in Pakistan began in the 1950's with the textiles sector being the main focus area. The Valika Textile mill at Karachi was set up in 1953 which set the tone for modern development of the textile sector in the country. By the mid-60's, there were 180 units of textile bleaching, printing and processing units, mostly in Punjab and Karachi. New mills were being established with the import of technology, but suffered from lack of technical staff and capital shortages. During the 1970s, the Cotton Export Corporation (CEC) controlled most of the textile exports of Pakistan (Tahir, 2013). The monopoly power wielded by the organization excluded the private sector from international cotton trade (Cororaton et al, 2008). The exports of cotton were subject to a minimum export price and benchmark pricing system. This was done to prevent under invoicing and to ensure a definite amount of export duty. However, in the later stages, the price intervention system of the CEC led to depression in domestic cotton

prices which eventually made the system untenable. The export duty was finally abolished in 1994 and domestic prices were in line with international prices. From the late 1980s to mid 1990s, the investment friendly policies of the government led growth of the textile industry. A number of incentives such as tax holidays and breaks was announced for new investments. It was in the 1990s that the modernization process kick started with a huge world demand for good quality fabrics with wide width. A huge expansion in the spinning sector also took place with the abolishing of the import duty on machinery for producing garments and made-ups during this decade.

The Economic Survey of Pakistan 2012-13 has noted that the textile industry is the most important manufacturing sector of Pakistan with the longest production chain with inherent potential for value addition at each stage of processing, from cotton to ginning, spinning, fabric, processing, made-ups and garments. The textiles and clothing sector is an important sector providing livelihood to more than 10 million farming families.

Several policies have been undertaken to boost the performance of the sector. A Textile Vision 2005 was developed by the Small and Medium Enterprise Development Authority (SMEDA) which suggested three different scenarios for the growth of the sector. In subsequent years, parts of the recommendations of the Textile Vision were implemented through trade policies and trade/investment promotion measures. A separate Textile Ministry was created a few years back for exclusive focus on textile and clothing sector.

The Strategic Trade Policy Framework (STPF) 2009-14 aims to increase exports of textile from Pakistan's existing exports USD 10 billion to USD 25 billion by the year 2015. This policy formulated as the first textile policy of Pakistan, made a large allocation of funds of about Pakistani Rupees 123 billion for this purpose. The key features of this policy include: establishment of a Textiles Investment Support Fund (TISF) for incentivizing investments in specific areas including modernization of machinery and technology, removing infrastructural bottlenecks, enhancing skills, better marketing and use of information and communication technology (ICT).

A Technology Up-gradation Fund (TUF) was announced for part financing of capital intensive projects. This proposed that for capital intensive projects, the government will pay 50 percent of interest cost of new investment in plant and machinery (maximum of 5 percent). For small investments, it was proposed that the government will contribute up to 20 percent of capital cost as a grant. The budget of Rs.1.6 billion was initially earmarked for this and was expected to increase to Rs. 17 billion by 2014. For development of infrastructure, the policy announced schemes for common warehousing, storage and marketing facilities and an amount of Rs. 1 billion was allocated for the same, to be built on public private partnership model.

Given the success of textiles city and garments cities models, there was a proposal to set up more such industrial estates to ensure availability of all industrial amenities at reasonable cost. Similarly for skill development, the policy proposed that a comprehensive training plan be developed to upgrade the overall pool of skills in the textiles value chain and also allocated Rs.

1 billion during the current year for skill development initiatives. This policy also lays down the sub-sector initiatives to be launched including those for ginning, spinning, weaving, knitting, processing, fashion design, handlooms and handicrafts, carpets and technical textiles. These schemes were to be launched on a public-private partnership basis with the aim to upgrade and improve these sectors.

However, in the recent years, Pakistan's textile industry is facing problems due to the energy crisis in the country. The energy shortages are creating pressure on Pakistan's crippled and debt-ridden economy. Despite a wealth of natural resources, Pakistan produces only 80 percent of its electricity needs and even some of that comes from imported fuel.

#### **4. Trade between India and Pakistan in Textiles and clothing**

##### ***4.1 Existing Trade between the two Countries***

Trade in the T&C sector between India and Pakistan occupies the largest share (24%) in total bilateral trade between the countries (WITS database). However, it occupies a negligible share in India-Pakistan bilateral trade in T&C with respect to the world.

**Table 1: Trade in T&C between India and the world and India and Pakistan with respective shares (2009-13)**

	<b>Indian T&amp;C exports to Pakistan</b>	<b>Indian T&amp;C imports from Pakistan</b>	<b>Indian exports to the world</b>	<b>Indian imports from the world</b>	<b>Share of T&amp;C exports in total exports</b>	<b>Share of T&amp;C imports in total imports</b>
	<b>In million USD</b>		<b>In million USD</b>		<b>(%)</b>	<b>(%)</b>
<b>2009</b>	566.2	45.3	21912.9	3215.9	3%	1%
<b>2010</b>	654.2	43.4	27127.8	3914.3	2%	1%
<b>2011</b>	393.8	39.1	33374.1	4934.2	1%	1%
<b>2012</b>	413.4	102.5	32682.9	5151.1	1%	2%
<b>2013</b>	655.9	66.1	40191.3	5410.1	2%	1%

*Source: Calculations based on data from UN COMTRADE*

The exports have shown an increasing trend except for a fall in 2011. Perhaps the revival of the trade talks between India and Pakistan in 2011 and the subsequent removal of the positive list led to the increase in exports thereafter. However, even though the quantum of exports has increased over the years, the share of T&C trade in total exports has gone down recording a minor increase in 2013.

The imports of T&C from Pakistan have been much lower than the exports. The imports showed an increasing trend from 2009 to 2012. However, the share of T&C imports in bilateral trade does not show a consistent trend.

**Figure 3: Trade in Textile and Clothing between India and Pakistan (2009-2013)**



Source: Based on data from UN COMTRADE

Since the total trade in the T&C sector between India and Pakistan shows a mixed trend, it would be worth investigating the trade in textiles and the clothing segments separately to get a sense of the importance of individual sectors.

#### **4.2 Trade Potential and Capitalization in the Textiles and Clothing Divisions**

The trade figures of T&C warrant a further analysis of the nature of trade in this sector between India and Pakistan. To analyze this, we have considered two segments—textiles (HS codes 50-60 and 63), consisting of yarn, fabrics, fibres, filaments, textile floor coverings and textile products for industrial use and clothing (HS codes 61 and 62) consisting of articles of apparel and clothing. Along with this, we have also calculated the trade potential of textiles and clothing. The export and import potential will give us an insight into the trade that can be achieved given the current trade levels between India and Pakistan. The Trade Possibility Approach has been used to calculate the potential. It is a simple, yet intuitive method that yields practical results (Taneja et. al 2013). It is calculated as follows:

$$\text{Min} (SE, MI) - ET \quad \text{-----} (1)$$

where SE, MI and ET are the reporting country's global exports/imports, partner country's global imports/exports and existing trade, quantified by the exports of the reporting country to the partner country (Taneja et al, 2013).

Trade potential calculated using the trade possibility approach, when considered in isolation would lend inflated figures. It is important to take into account the comparative advantage of the country in question to yield realistic results. Comparative advantage is the term used to describe the tendency for countries to export those commodities which they are relatively adept at producing, vis-à-vis the rest of the world. In other words, if a country can produce a good at

a lower relative cost than other countries, then with trade, that country should devote more of its scarce resources to the production of that particular good. Through trade, that country can obtain other goods at a lower price (opportunity cost), in exchange for the good in which it has a comparative advantage (Bhattacharya, 2011).

The revealed comparative advantage (RCA) measures if the share of products in the exports of a country is higher than its international participation (Data viva). The concept of revealed comparative advantage (Balassa 1965, 1977, 1979, 1986) pertains to the relative trade performance of individual countries in particular commodities. On the assumption that the commodity pattern of trade reflects the inter - country differences in relative costs as well as in non-price factors, this is assumed to “reveal” the comparative advantage of the trading countries (Batra & Khan, 2005). The revealed comparative advantage of a nation is measured by the relative weight of a percentage of total export of commodity's in a nation over the percentage of world export in that commodity. Balassa (1965) suggested the following of index of RCA:

$$RCA_{ij} = \frac{\frac{X_{ij}}{X_{wj}}}{\frac{X_i}{X_w}} \text{-----}(2)$$

Where  $X_{ij}$  are the  $i$ th country's exports of commodity  $j$

$X_{wj}$  are the world exports from country of commodity  $j$ ,  $X_i$  are the total exports of country  $i$  and  $X_w$  are the total world exports.

We have followed a two-stage method to arrive at the realistic export and import potential figures. First, we have used the trade possibility approach to calculate the trade potential figures. Then, to select the commodities in which the country has a comparative advantage, we have mapped the commodities with an RCA greater than 1 to the respective export/import potential figures. For instance, to calculate the potential for importing textile and clothing items from Pakistan, the figures were calculated by using data for India's global imports, Pakistan's global exports and India's imports from Pakistan and applying formula (1). The RCAs (taking in account Pakistan's exports, in this case) were also calculated using formula (2) and those commodities with an RCA greater than 1 were then mapped with the import potential figures. The import potential figures for each of the commodities with RCA greater than 1 were then added up to arrive at the figures in Table 1.

Additionally, we have also calculated the ratio of current exports to export potential to assess how much of the trade is being capitalized on.

**Table 2: Export and Import potential in textiles between India and Pakistan**

<b>T&amp;C EXPORTS</b>					
	<b>India's exports to world (2013)</b>	<b>India's exports to Pakistan (2013)</b>	<b>Share in world exports</b>	<b>Export Potential</b>	<b>Potential capitalization ratio= current exports/export potential</b>
	<b>In million USD</b>		<b>( %)</b>	<b>In million USD</b>	<b>( %)</b>
<b>Textile</b>	24488.8	654.6	3	1223.9	53.5
<b>Clothing</b>	15702.4	0.65	0	12.9	5
<b>Total</b>	40191.2	655.3	3	1236.8	53
<b>T&amp;C IMPORTS</b>					
	<b>India's imports from the world (2013)</b>	<b>India's imports from Pakistan (2013)</b>	<b>Share in world imports</b>	<b>Import Potential</b>	<b>Potential capitalization ratio = current imports/ import potential</b>
	<b>In million USD</b>		<b>( %)</b>	<b>In million USD</b>	<b>( %)</b>
<b>Textile</b>	4605.2	64.1	1	642.6	9.9
<b>Clothing</b>	416.7	2.1	1	251.3	0.8
<b>Total</b>	5021.9	66.2	2	893.9	7

*Source: Calculations based on data from UN COMTRADE*

The figures clearly show that trade between India and Pakistan is mainly concentrated in textile items. The textiles segment has majorly driven the T&C exports from India to Pakistan. The share of India's textile exports to Pakistan in world trade is close to 3 percent. Even though this share in world exports is very low, the export potential for textiles from India to Pakistan has been capitalized to the extent of 53%. The share of imports of textiles from Pakistan in world imports is also very low. Textiles imports of India from Pakistan occupy a miniscule 1 percent share in world trade. However, the potential for textiles imports is 10 times the current textile imports of India from Pakistan. As a result of the low trade, the import potential has been capitalized only to the extent of 7% of the current imports. With regard to the clothing segment, the quantum of exports and imports is much lower than that of textiles. However, India's import potential in clothing from Pakistan is proportionately higher than the export potential. A noteworthy point is the incredibly high import potential in clothing from Pakistan that has not been tapped till now-- only 0.8 percent of the potential has been capitalized by India in imports of clothing from Pakistan. Why has India not been able to exploit the import and export potential? Why are the trade figures so low? Perhaps an analysis of the restrictions in trade between the two countries will provide answers to these questions.



### *4.3 Sensitive and Negative list Analysis*

Trade between India and Pakistan has also been affected by the maintenance of sensitive lists and the negative list. Pakistan maintains a negative list for India consisting of items that cannot be imported from India. Only certain goods specified are importable via land route from Wagha. Being members of SAFTA, the countries also have sensitive lists consisting of items that are exempted from the low SAFTA tariffs. The negative and sensitive lists operational in Pakistan applicable to India and the sensitive list maintained by India for Pakistan are indicative of the sectors in which the two countries want to offer protection to domestic industries from each other's imports (Taneja et al, 2013). The textile and clothing items make up for 5.7 percent of the items in Pakistan's negative list. As opposed to that, T&C items make up for almost 25 percent of the sensitive lists of both countries. Out of 614 items, India has 176 T&C items in its sensitive list which accounts for the largest number of items of a particular sector in the list.

Most of the textile items in Pakistan's negative list consist of man-made filaments and man-made fibres (across HS codes 54 and 55). The clothing items (across HS codes 61 and 62) consist of 9 items of apparel and clothing accessories—knitted and crocheted. India ranks second in the production of polyester textile yarn production in the world (Oerlikon Textile, 2010). The top ten synthetic fibres consuming countries in 2007 accounted for 76% of world synthetic fibre consumption, and included (in decreasing order) China, the United States, India, Japan, the Russian Federation, Germany, South Korea, the United Kingdom, Italy, and Pakistan (Food and Agriculture Organization of the United Nations and International Cotton Advisory Committee, 2013). Clearly, India features in the top ranks of countries producing man-made filaments and fibres. Pakistan has competitive advantage in cotton textile products. India, on the other hand, has an upper hand in silk and other synthetic fibre. This throws open the opportunity for Pakistan to utilize India's large production of materials, especially polyester stable fibre (PSF) and polyester filament yarn (PFY). However Pakistani textile manufacturers are apprehensive of the competition that they will face from Indian polyester producers. Besides the scale, the Indian government gives tax breaks, subsidy on interest, tariff protection, land on concessional rates and other favours (Hasan, 2014). However, is the favourable treatment provided to the Indian textile government a strong enough argument to restrict trade by way of maintaining a negative list? Maybe not. As per WTO, subsidies for production fall in the "actionable" category where the affected importing country can impose countervailing duties to offset the disadvantage to its local manufacturers due to the cheaper imported item. According to the Agreement on Subsidies and Countervailing Measures (SCM Agreement), actionable subsidies are not prohibited. However, they are subject to challenge, either through multilateral dispute settlement or through countervailing action, in the event that they cause adverse effects to the interests of another Member. There are three types of adverse effects. First, there is **injury** to a domestic industry caused by subsidized imports in the territory of the complaining Member. This is the sole basis for countervailing action. Second, there is **serious prejudice**. Serious prejudice usually arises as a result of adverse effects (e.g., export displacement) in the market of the subsidizing Member or in a third country market. Thus, unlike injury, it can serve as the basis for a complaint related to harm to a Member's export interests. Finally, there is **nullification or impairment** of benefits accruing under the GATT

1994. Nullification or impairment arises most typically where the improved market access presumed to flow from a bound tariff reduction is undercut by subsidization. The Pakistan textile industry can resort to this clause under WTO if it feels threatened by Indian textiles inundating their market.

With respect to the maintenance of sensitive lists, it is important to look at the value of imports subject to the higher tariffs under the respective lists of the countries. This will throw light on whether these lists actually pose a restriction to trade between both the countries. The proportion of the Pakistani T&C items that are part of Pakistan's sensitive list is a mere 4% of the total T&C imports from India. On the other hand, the share of imports of Indian textiles from Pakistan that are a part of India's sensitive list is as high as 42%. So, while Pakistan does restrict trade by maintenance of the negative list, India is also trying to protect its textile industry by way of applying non-concessional tariffs on items in the sensitive list.

**Table 3: Textile items in the negative and sensitive lists**

	<u>Segments</u>	<u>Number of items</u>	<u>Remarks</u>
Pakistan's negative list	Textile	60	Most of the items consist of man-made filaments and man-made fibres (HS codes 54 and 55). Items from the clothing segment: of wool, cotton and man-made fibres
	Clothing	9	
Items importable from India through Wagah	Textile	48	Single yarn of combed and uncombed fibres, multiple or cabled yarn of combed and uncombed fibres and raw jute (HS codes 52 and 53)
Pakistan's sensitive list	Textile	70	Items in this list range from woven fabrics (of man-made fibres) to carpets and knitted fabrics. Majority of the items are in the clothing segment (HS Code 61 and 62). Bed linen (HS 63) , sacks and bags are also under the sensitive list
	Clothing	149	
India's sensitive list	Textile	30	Textile items include cotton yarn, woven fabrics of artificial and polyester staple fibres, carpets and knitted fabrics of cotton. RMG – menswear, women's wear, t-shirts, jerseys, track suits, gloves, shawls etc.
	Clothing	146	

Source: SAFTA related documents retrieved from [www.saarc-sec.org](http://www.saarc-sec.org)

Apart from the fact that a majority of the items that are importable through the Wagah border consist of textile items, the proportion of these items in Pakistan's imports of textile items from India is as high as 85%. This figure points to the importance of single yarn of combed and uncombed fibres in Pakistan's imports from India. However, a caveat is that these items are

not part of the negative list and it is quite possible that they are being exported to Pakistan through other routes such as sea and air. Nonetheless, their importance in the bilateral trade of textiles remains.

## **5. Nature of Trade in Textiles and Clothing between India and Pakistan**

An insight into the top exports and imports of textile and clothing items between India and Pakistan will help in highlighting the trade basket. Among the top 10 textile exports from India to Pakistan, cotton has the highest share in bilateral trade. India exports many varieties of cotton yarn containing 85% or more cotton in terms of the count of the fabrics. Woven fabrics of polyester and polyamides and yarn of synthetic staple fibres also occupy a substantial share in India's total exports of T&C to Pakistan. In fact, the share of exports of synthetic fibres is quite substantial after that of cotton yarn containing 85% or more cotton measuring less than 83.33 decitex<sup>5</sup>. An impressive 38% of cotton yarn, single, of combed fibres, measuring less than 106.38 dtx and 69% of the same yarn measuring less than 83.33 dtx as a proportion of India's global exports to the world is exported to Pakistan.

Of the top 10 Indian exports, 6 items fall in the category of cotton yarn (other than sewing thread) containing 85% or more by weight of cotton not put up for retail sale. Other top export items consist of man-made staple fibres like polyester.

The top imports of T&C from Pakistan are cotton, not carded or combed and wool, not carded or combed. The share of Pakistan's cotton imports as a proportion of India's global exports is a meager 5%. The nature of trade in case of woven fabrics is interesting to note. Woven fabrics of cotton weighing more than 200 g/m<sup>2</sup>, make up for 30% of India's global imports even though the import values are much lower. This can be attributed to the fact that Pakistan's strength lies in woven fabrics and India imports a substantial quantity from Pakistan. Within the clothing segment, the Pakistani exports of woven fabrics have registered robust growth during the last two decades (WITS database). The production of woven cotton cloth has increased substantially and serves as the main strength for downstream sectors such as bed wear, made-ups and garments (Pakistan Economic Survey, 2011-12).

An analysis of the top import and export items of India from and to Pakistan shows that cotton, not carded or combed has the highest trade values in case of both exports and imports. Apart from cotton, other closely related items in this segment include woven fabrics of cotton, containing 85% or more by the weight of fabric. Trade in similar segments of textiles and clothing seems to be the hallmark of bilateral trade between India and Pakistan. Such trade patterns resonate with the trade theories on intra-industry trade or the simultaneous export and import of similar type of goods. Similarity is identified here by the goods or services being classified in the same "sector" (Marrewijk, 2008).

### 5.1 Intra-Industry Trade in Textiles and Clothing

An analysis of the intra-industry trade in textiles between India and Pakistan will help pick out items with bilateral trade potential between the countries. Intra-industry trade has been the dominant form of trade in the textile sectors between India and Pakistan. We have tried to quantify this overlap of imports and exports at a given aggregation level by calculating the intra-industry trade index. The Grubel-Llyod (GL) index is the standard index used to measure intra-industry trade. It is calculated as follows:

$$IIT_{jt} = 1 - \left( \frac{|x_{ij}^k - m_{ij}^k|}{x_{ij}^k + m_{ij}^k} \right)$$

where  $x_{ij}^k$  are the exports from India to Pakistan of commodity  $k$  and  $m_{ij}^k$  are the imports of India from Pakistan of commodity  $k$ .

An IIT of the value 0 would indicate pure inter-industry trade (or trade within different sectors) and an IIT index of value 1 would indicate pure intra-industry trade.

**Table 4: Intra-industry trade in the T&C sector at the 6 digit level (2013)**

Product	Product Name	IIT in 2013
621790	Parts of Garments or of Clothing Accessories	0.96
520829	Other Woven Fabrics of Cotton (Cotton 85% or More; Not More than 200g/m <sup>2</sup> ; Bleached)	0.95
580429	Mechanically Made Lace of Other Textile Materials	0.90
520831	Plain Woven Fabrics of Cotton (Cotton 85% or More; Dyed; Not More than 100g/m <sup>2</sup> )	0.89
630900	Worn Clothing and Other Worn Articles	0.89
520851	Plain Woven Fabrics of Cotton (Cotton 85% or More; Printed; Not More than 100g/m <sup>2</sup> )	0.88
581099	Embroidery of Other Textile Materials, in the Piece, in the Strips	0.87
550810	Sewing Thread of Synthetic Staple Fibres	0.87
620590	Men's or Boys' Shirts, of Other Textile Materials	0.86
521213	Other Woven Fabrics of Cotton (Dyed; Weighing Not More than 200g/m <sup>2</sup> )	0.81
620339	Men's or Boys' Jackets, Blazers, of Other Textile Materials	0.80

Source: Calculations on Tradesift using data from UN COMTRADE

The  $IIT_{jt}$  at the six-digit level shows that intra-industry trade is the highest in parts of garments/clothing accessories and woven fabrics of cotton. In fact, among the top 10 items woven fabrics of cotton containing 85% more by weight of cotton not put up for retail sale are

both exported to and imported by India. Other items with a high level of intra-industry trade in the textiles segment include embroidery, sewing thread of man-made staples and mechanical lace. Among the items in the clothing segment, parts of garments and clothing accessories had the highest intra-industry trade index in 2013.

**Table 5: intra-industry trade in the T&C sector at the 2 digit level (2011-13)**

HS codes	Textile and Clothing items	2013	2012	2011
62	Articles of apparel and clothing accessories, not knitted or crocheted.	0.63	0.62	0.70
53	Other vegetable textile fibres; paper yarn and woven fabrics of paper yarn.	0.51	0	0.27
63	Other made up textile articles; sets; worn clothing and worn textile articles; rags.	0.20	0.41	0.66
58	Special woven fabrics; tufted textile fabrics; lace; tapestries; trimmings; embroidery.	0.17	0.17	0.12
52	Cotton	0.16	0.50	0.17
59	Impregnated, coated, covered or laminated textile fabrics; textile articles of a kind suitable for industrial use	0.14	0.17	0.27
57	Carpets and other textile floor coverings.	0.12	-	0.09
61	Articles of apparel and clothing accessories, knitted or crocheted.	0.11	0.02	0.11
56	Wadding, felt and nonwovens; special yarns; twine, cordage, ropes and cables and articles thereof	0.07	0.20	0.64
50	Silk.	0.07	0.24	0.11
60	Knitted or crocheted fabrics.	0.05	0.17	0.20
51	Wool, fine or coarse animal hair; horsehair yarn and woven fabric.	0.02	0.12	0.27
54	Man-made filaments.	0.01	0.01	0.03
55	Man-made staple fibres.	0.01	0.01	0.02

*Source: Calculations on Trade Sift using data from UN COMTRADE*

At a more aggregated level, the indices show that apparel and clothing has had the highest intra-industry trade index in the years 2011-13. Except for a high IIT index of 0.50 in 2012, there has been low intra-industry trade in the cotton segment. Interestingly, if we consider the top 10 exports and imports of T&C between the two countries, apparel and clothing items do not figure in the top 10 items of trade between India and Pakistan in terms of value. Instead, cotton occupies a dominant position in trade between the two countries, accounting for 82.3% in the top 10 exports of India to Pakistan and 63.92% in the top 10 imports of India from Pakistan (refer Annexure 1 and 2). So, even though the quantum of trade in the garments and apparel segment is not very high, there is a high overlap of India and Pakistan's imports and exports in

their bilateral trade. Such a pattern of trade reflects complementarities in trade in T&C between India and Pakistan. The very fact that both countries exchange different varieties of items in similar segments illustrates the potential for increased trade, especially in the apparels and woven fabrics segment. With such high levels of similar trade, it is worth exploring the type/nature of intra-industry trade in T&C. There are two different types of intra-industry trade—horizontal and vertical. Horizontal IIT (HIIT) represents an exchange of commodities within broadly similar levels of quality or stage of processing while vertical IIT (VIIT) is defined as exchange of commodities with different levels of quality or stage of processing.

## ***5.2 Components of Intra-Industry Trade Index***

A typical textiles value chain starts with cotton production, which then passes through ginning where fiber is separated from the cotton seed. The next stage is spinning where the fiber is spun into yarn. At this stage, Manmade Fibers (MMF) such as polyester is also used as substitute for cotton fiber. The next stage of processing includes knitting and weaving depending on the type of fabric to be produced. The knitted or woven fabric then goes through dyeing and further processing such as bleaching. Once the fabric is processed, the last stage is stitching through which various made-ups are produced. Additional steps in the value chain include branding and retailing. These core activities of the value chain are facilitated by a network of supporting activities that include transport and logistics as well as export support.

To analyze the nature of intra-industry trade between India and Pakistan, for each product at the 6-digit level, we separate the total IIT into two components—horizontal and vertical, using the relative unit values of exports and imports. Unit value can be used as an indicator of the average price of a particular good for assessing product quality in trade data. The underlying assumption is that relative prices are likely to reflect relative qualities (Stiglitz, 1987). Unit values can be calculated in several ways: per item, per tonne, per square metre, etc. (Ferto and Hubbard, 2002).

For this exercise, unit values have been calculated by dividing trade value by quantity. However, using unit values has certain disadvantages. Unit values may be positively associated with size, whereas other characteristics more closely related to quality, like durability and reliability, may be inversely associated with size, causing interpretation problems. They also might be affected by the quantity, causing unit values to be deflated or inflated, as the case may be. Despite these shortcomings, the use of unit values has become common in the measurement of horizontal and vertical intra-industry trade. Following the general practice in literature, IIT is defined as HIIT if the ratio of export unit value to import unit value is within the range of 0.75 to 1.25. When ratios are outside the specified range, IIT is considered to be vertical in nature (Tewari, 2014). After calculating the unit values, we have counted the number of items with unit values less than 0.75, between 0.75 and 1.25 and more than 1.25 to classify them into the respective types of IIT.

	2009	2010	2011	2012	2013
	Number of items				
HIIT ( between 0.75 and 1.25)	15	4	18	40	29
VIIT (less than 0.75 and more than 1.25)	32	44	32	19	34

*Source: Calculations based on data from UN Comtrade*

The results show that most of the items traded have unit values that are less than 0.75 and more than 1.25 through the years 2009 to 2013. This implies that the trade in T&C is more of the VIIT nature than HIIT. This would imply that trade is mostly concentrated in items that need processing and are different in terms of quality. The nature of VIIT in textiles and clothing can be attributed to the textile value chains that exist in the sector and can be tapped to enhance trade in T&C between India and Pakistan.

### **5.3 High Quality vs. Low Quality**

The VIIT can be further subdivided into two categories- high quality or high value VIIT (HVIIT) and low quality VIIT (LVIIT). If the ratio of unit value of export to import is greater than 1.25, then the quality or processing stage of exports is higher than that of imports (HVIIT), while ratios below 0.75 indicate higher quality of imports compared with exports (LVIIT).

	2009	2010	2011	2012	2013
	Number of items				
LVIIT (less than 0.75)	7	13	22	7	10
HVIIT (more than 1.25)	25	31	10	12	24

*Source: Calculations based on data from UN Comtrade*

The results show a rather mixed pattern of high and low value VIIT over the years 2009 to 2013. Leaving aside the results of the year 2011, which seems to be an outlier, the number of items in which high vertical IIT is occurring seems to be much greater than the items with a low VIIT. Since much of the IIT in the T&C sector represents VIIT, this implies that the unit values of products exported by India are generally higher than that of imports. Since the quality or processing stage of exports is higher than that of imports, it seems Indian exports are more likely to be high-quality processed exports. This points towards the complementarities in the textile sectors between India and Pakistan.

## **6. Findings from the survey**

To supplement the secondary research, interviews were conducted with stakeholders and textile traders in India and Pakistan. These were semi structured interviews with Confederation of Indian Textile Industry (CITI) (New Delhi), The Textile Association (India) (Mumbai), Textile Machinery Association (TMA) (Mumbai), Textile Commissioner (Mumbai) , National Textile Corporation (NTC) (Mumbai and Coimbatore), and Southern India Mills' Association (SIMA) (Coimbatore) in 2012-13. The questions posed in the interviews were mainly concerned with

the progress of the sector in the two countries, their strengths and weaknesses and the potential for trade between the two countries.

### **6.1 Cotton production**

Cotton production in India is concentrated in three states, Gujarat, Maharashtra and Andhra Pradesh. Among these three states the yield of cotton in Gujarat (1000kg/hectare) surpasses the international standards. In terms of production of cotton, Gujarat accounts for 33 percent of the total cotton produced but only accounts for 20 percent of acreage, while Maharashtra has the largest acreage among the three states but contributes only 30 percent of the total production of cotton.<sup>6</sup> India's total production of cotton is higher than that of Pakistan because the total acreage in India is higher (almost double that of Pakistan). India's average yield is 500 kg/hectare and the corresponding figure in Pakistan is 600 kg/hectare. This is much lower than the international standard yield of 750 kg/hectare. However, Pakistan definitely has a competitive advantage over India in terms of productivity (*CITI*, Interview, New Delhi).

### **6.2 Spinning**

India has the second largest spindle capacity in the world. It accounts for 22 percent of the world's spindle capacity, while Pakistan is the third largest and accounts for 12 to 14 percent of the world's spindle capacity. On an average India produces 4600 million kg of yarn while Pakistan produces 3000 million kg of yarn in a year. Exports of yarn from both the countries, relative to total production is in the range of 20 to 25 percent, though in absolute value terms India exports more yarn to the world than Pakistan. (*CITI*, Interview, New Delhi)

The TUFSS scheme has been instrumental in increasing the spindle capacity in India. About 95 percent of the yarn in India is produced in the organized sector with the latest machines, which boosts the competitiveness in this segment. There are approximately 35000 spindles and manufactured cotton (40-150 counts), polyester (40-76 counts) and polyester cotton (30-64 counts) yarn. Constant availability of power is a major concern which the spinning industry faces, and the cost and availability of electricity determines India's competitiveness in this segment. (*CITI*, Interview, New Delhi)

The spinning segment is also one of Pakistan's biggest strengths - it is highly organized with huge capital investments and in this segment, there are very few medium and small firms. There has been a lot of investment in the spinning sector in Pakistan which has reduced the average machinery age to 7-8 years (*Industry interviews*, Lahore). In 2008, 50 percent of their spinning segment was modernized. However, Pakistan does not have finer quality of cotton and specializes in production of only few counts of yarn (less than 20). India on the other hand has

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<sup>6</sup> The Northern region is the primary producer of short and medium staple cotton and the southern states primarily grow long staples. The central region produces medium and long staples (ITC, 2007).



cotton of much higher quality and Indian spinning mills are more advanced, producing a variety of yarn ranging from 20 to 150 counts<sup>7</sup> (*The Textile Association*, Interview, Mumbai).

On the spinning part, the production segment of the spinning sector in Pakistan is tilted towards the production of coarser categories of yarns over average count of 20. There is a huge potential for trade in textiles between the two countries, for instance, in lower count of yarn of less than 20, which is largely imported by Indian garment manufacturers from the rest of the world.

### 6.3 Weaving

Yarn can be spun in the form of a coon or in the form of hank-yarn. The coon is the standard spun yarn which is used by the mills and power looms for the process of fabrication both in the domestic and export market. The hank yarn obligation for the spinning mills in India restricts 40% of the total output for the handloom sector. The profits in production of hank yarn are low, since the cost of production increases as additional processes are involved to prepare the yarn in hank form. Also, the price for hank yarn is fixed in the domestic market (which is lower than market price of yarn in a coon) and cannot be exported, therefore the prices which are realized are also low. Usually as an industry practice, the worst quality of cotton is used for the production of hank yarn to save input costs (*CITI*, Interview, New Delhi).

The Indian weaving industry is relatively underdeveloped as even today, 40 thousand looms have old technology. Also 80 percent of the shuttle-less looms are second hand which reduces the competitiveness of the industry (*Textile Machinery Association*, Interview, Mumbai).<sup>8</sup>

The weaving sector in Pakistan has both large firms (60 percent) and SMEs (40 percent). Pakistan generally produces a standard quality of yarn and has brands like Fax and Kohinoor. Pakistan's weaving industry is also very strong with advanced wider width looms. There has also been a significant amount of product diversification, for instance in cotton blending. In the last 10-12 years, there have been massive investments in denim wear in Pakistan. Due to its good cotton and low yarn count as well as strength in weaving, Pakistan's jeans are sourced to all the major global brands. (*Industry interviews*, Lahore)

Entrepreneurs in India are not able to take full advantage of schemes like TUFs as weaving machines are costly, while the gestation period for returns is long and the market is very demand elastic. This is unlike spinning, which is very viable with maximum returns and demand does not depend on final consumer. Even in the processing industry, Indian firms do not have sophisticated machinery as majority of the players is small. Environment norms also

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<sup>7</sup> ITC (2007) notes that while India produces all counts of cotton, Pakistan produces medium and medium long staple and imports long staple. Fine and super fine counts are made from imported cotton in Pakistan.

<sup>8</sup> Out of 96 looms, 36 were modernized to shuttle less in 2008 by NTC in India. Full modernization was not undertaken by so as to retain workforce. Rs 2000 crores of investment across NTC increased productivity by 30-40 percent and the workforce engaged reduced to less than half. The total output of 124 units before modernization is equivalent to that of 23 semi modernized ones today.

act as a barrier in the processing industry as processing is a very polluting industry. Also, there is a shortage of skilled manpower. (*Textile Commissioner*, Interview, Mumbai).

In the weaving sector, Pakistan is stronger than India due to high investment. Investments did not take place in the weaving sector in India due to the small scale industrialisation policy that was in place and the smaller fragmented holdings which without financial support and low risk appetite, faced uncertainty in the demand for fabric.

#### **6.4 Production of fabric**

Fabrication is undertaken by the following sectors in India:

- a) Mills – account for only 4 percent of the total production of fabric in India
- b) Handloom sector – accounts for 20 percent of the total production of fabric in India
- c) Decentralized Power Looms – account for 30 percent of the total production of fabric in India
- d) Hosiery mills (knitted fabric sector) – account for 46 percent of the total production of fabric in India

India produced about 62 billion square metre of fabric in 2011 while Pakistan produced about 30 billion square metres. The quality of fabric from mills is better in India vis-à-vis Pakistan but the production of mill fabric in India only accounts for 4 percent. Majority of the fabric in Pakistan is produced by shuttle less looms. The fabricating sector in Pakistan upgraded to shuttle-less looms from shuttle looms in the early 1990s but due to the reservation in India of the textile sector in SME, the up gradation to shuttle less loom has picked up in the Indian textile industry in the last few years. The total production of fabric by the handloom sector is about 20 percent and given this fact, the hank-yarn obligation needs to be lowered for the spinning mills in India. (*CITI*, Interview, New Delhi).

Although India is self sufficient in fabric production, imports of fabric from Pakistan also occur due to two reasons. First, the exchange rate favours Pakistan, and many garment producers from India source materials from Pakistan since the price is lower due to the exchange rate advantage. Second, India's trade policy for imports of raw material for exports of final goods gives a lot of benefits/incentives to the firm, and sometimes firms import fabrics to avail these benefits. (*CITI*, Interview, New Delhi)

Pakistan is the second largest exporter of home textiles in the world. In terms of use of fabrics, for Pakistan a larger proportion is used as made-up in comparison to India. Pakistan's textile industry is eyeing the market for made up textiles which is expanding in India due to the reality sector boom and rise of the Indian middle class, but would face stiff competition from Indian textile firms (*CITI*, Interview, New Delhi). Pakistan's processing industry is stronger than India's due to strength in dyeing and printing of woven fabrics and in processing shirting and trousers. The Pakistani processing sector has a 50-50 mix of large and SME firms.

Embroidering and printing are generally outsourced due to limitations of generalized skill of labour. (*Industry interviews*, Lahore).

### **6.5 Knitting**

In the last few years the textile industry in India is looking to shift away from weaving to knitting which is a less capital intensive process. Till 2003 the knitting sector was reserved for the small scale sector, but the Indian knitting sector is picking up because of increased demand. The knitting process is one which was invented in Europe and increasingly the European economies are dismantling production capacity, and moving into India. The major knitwear sector in India is based out of Tirupur and Ludhiana. A similar movement is seen in Pakistan but still there is a domination of woven fabric (*CITI*, Interview, New Delhi).

### **6.6 Synthetic and other fibres**

With respect to availability of manmade fibres (MMF) India has a clear advantage over Pakistan. India is the largest producer of manmade fibre, though India is not price competitive (*CITI*, Interview, New Delhi).<sup>9</sup> Pakistan is not very strong in producing synthetic fabrics; the only strong area in this field is polyester staple fibres (*Industry interviews*, Lahore).

India's trade in MMF readymade garments globally is 35-40 percent for cotton and 60-65 percent in MMF. While India produces 60 percent cotton garments and 40 percent MMF garment, it exports about 70 percent of cotton garments and 30 percent MMF garment. Given the trend and demand globally of MMF the Indian textile industry needs to develop competitive edge in the MMF segment. India's strength lies in cotton which is a relatively cheaper fiber in India. The MMF industry feels that cotton should be taxed as their industry is at a relative disadvantage due to higher costs/prices and does not get any benefit from the government (*CITI*, Interview, New Delhi).

There has hardly been any growth in trade between the two countries in knitwear (RMG) as there is more competition in this segment. Pakistan's lowers are very competitive. India produces both uppers and lowers but it is not very competitive in lowers. The RMG sector in Pakistan has mostly small and medium enterprises (90 percent). Just as in the case of India, the lower segment of the RMG market in Pakistan is extremely price sensitive and manufacturers face huge losses (*Industry interviews*, Lahore).

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<sup>9</sup> India is the second largest producer of Polyester Staple Fibre (PSF), Polypropylene Filament Yarn (PFY), Viscose Filament Yarn (VFY), the third largest manufacturer of Viscose Staple Fibre (VSF) and eighth largest manufacturer of Acrylic Staple Fibre (ASF) in the world. Pakistan could import PFY, VSF, and VFY from India, though some of these items are on Pakistan's negative list.

In case of jute manufacturing, India is one of the largest producers in the world and has a clear advantage over Pakistan. Even in silk production, India has a larger production base than Pakistan (CITI, Interview, New Delhi).

### ***6.7 Informal Trade in Textiles and efforts to tap the Trade Potential***

Trade between India and Pakistan is also characterized by informal flow of goods, particularly due to tariffs on certain commodities, non-tariff barriers to trade and the inadequacies of transportation and infrastructure for formal trade (Ahmed et al, 2015). Trade in ethnic garments constitutes a major share in this informal trade. Textile items such as apparel and clothing and carpets attract a customs duty of 25 percent. In a survey on informal trade conducted by Ahmed et al (2015), the main textile items found in the informal markets are Indian raw silk, cotton, Banarsi saris, muslin and readymade bridal dresses. The increase in demand for ethnic Indian garments is mainly attributed to the influence of media. The demand for ethnic ladies' suits increases significantly during the peak wedding season (after August). Saris account for USD 204.40 million and fancy dresses account for (including bridal wear) for USD 1152 million of the informal trade between India and Pakistan. The study also noted that some vendors import Indian cloth through Dubai and Singapore. In this case, the Indian cloth that goes to Dubai or Singapore is not stamped for its origin. An ICRIER survey conducted from the Indian side in 2013-14 states that textiles constitute 20% of the total informal exports from India to Pakistan. There has been a lot of demand for Indian synthetic fabric, silk-based fabrics and salwar kameez dupatta in Pakistan. Majority of the exports are from Surat and South India. With a value of USD 350 million, Indian informal imports of textiles constitute 49% of the total informal imports. Indian traders import textiles informally via Samjhauta Express, cross-LoC trade routes and sometimes even via Dubai (ICRIER Survey, 2013-14).

The value of informal trade in the textiles sector is also the highest, similar to formal trade in the sector. The surge in trade in textiles, especially, ethnic garments was particularly seen after the bout of liberalization in 2012, when Pakistan shifted to a negative list. This has also been documented by the survey with importers, exporters, wholesalers, retailers, transporters, customs clearing agents, *khepias* undertaken in Pakistan. To formalize trade and enhance bilateral trade relations, efforts have been made at the Track-II level wherein textile firms have collaborated to showcase apparels and clothing from either country (Refer Box 1).

#### **Box 1: Efforts to Collaborate in T&C between India and Pakistan**

Retail brands, fashion houses and textile firms in India and Pakistan have made several efforts to carry forward cross-border collaborations in the past. Fashion labels from Pakistan such as Gul Ahmed and Khadi have expressed keen desire to partner with Indian fashion brands. The Shan-e-Pakistan event has held two editions in 2015 and 2016 that brought together fashion designers and retail brands on one platform. Such events give a push to Track II diplomacy, which is much needed to improve India-Pakistan trade relations. The Lakme Fashion Week held in 2014 also showcased designers from Pakistan. Apart from these events, Alishan Pakistan was another lifestyle event held in New Delhi in 2012 and 2014 to encourage business and realize the trade potential between the two countries.

## Conclusion

The T&C sector occupies a pivotal position in the economies of India and Pakistan. Over the years, the textile policies of India and Pakistan have evolved, recognizing the importance of the sector in GDP, employment and trade. Among the major sectors of trade such as minerals, fuels, chemicals, vegetables and machinery, T&C saw a tremendous increase in bilateral trade between India and Pakistan post 2005. The potential for trade between the two countries is also exemplified by the similarities in culture, tastes and preferences in clothing. However, in spite of the USD 2.1 billion trade potential in T&C, the trade between both countries in this sector remains low. The low trade potential capitalization ratios in the textile and clothing sectors signal the scope for more engagements between India and Pakistan in these sectors. Though the export potential capitalization ratio is as high as 53%, most of it is attributable to trade in textiles. As compared to this, the import potential capitalization ratio of 7% is very low. The negative list is not the only barrier to trade in T&C between India and Pakistan. The sensitive list that India maintains for NLDCs under SAFTA covers 42% of the trade in T&C between both the countries. Hence, trade barriers in the form of negative list of Pakistan and the non-concessional tariffs by India have hindered trade in T&C between both countries. The favourable treatment towards the Indian textile industry is an argument advanced by the Pakistan textile firms for keeping textile items in the negative list. However, this might not be a completely valid reason since countervailing duties can always be imposed as per the WTO. The abolition of the negative list maintained by Pakistan and reduction of India's sensitive list are the first steps that need to be undertaken to tap the potential in this sector.

The nature of trade in the sector between the countries brings out the potential to integrate in the supply chains. An examination of the trade data shows existence of high intra-industry trade in items of cotton, especially woven fabrics. India is one of the world's leading producers of man-made filaments and Pakistan's competitive advantage lies in cotton production. This suggests some inherent complementarities that need to be capitalized. A strong overlap of T&C items traded between the countries has also been found. This signals potential, particularly in the segment of apparel and clothing accessories. The trade in cultural and ethnic clothing, especially salwar kameez dupatta has certainly received a boost with designers from both nations collaborating and making efforts to showcase their works in both countries.

In the South Asian region, India, Pakistan, Bangladesh and Sri Lanka are the major T&C exporters. Pakistan and India could join hands with Bangladesh and Sri Lanka to jointly liberalize trade in at least those textile value chain items that they import from outside the region to reduce their costs owing to lower transportation costs (The International News, Pakistan, 2014). There is huge diversity in terms of the T&C production in South Asian countries. There is a need to enhance the exchange of T&C with different levels of processing between India and Pakistan. This would eventually pave the way for collaboration in the textiles segment within South Asia and help the region to gain access to the supply chains in textiles.

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## ANNEXURE

### Annexure 1: Top 10 Indian T&C exports to Pakistan (2013)

HS Code	Items	India's exports to Pakistan	India's global exports	Difference between India's exports to Pakistan and its global exports	Share= India's exports to Pak/India's global exports to the world
		In million USD			(%)
520100	Cotton, not carded/combed	352.4	4513.4	4161	8%
540710	Woven fabrics obt. from high tenacity yarn of nylon/other polyamides/polyesters	87.2	555	467.8	16%
520527	Cotton yarn, single (excl. sewing thread), of combed fibres, containing 85%/more by weight of cotton, measuring <106.38dtx. but not <83.33dtx. (>94 metric number but not >120 metric number), not put up for retail sale	33.5	88	54.5	38%
550410	Artificial staple fibres, not carded/combed/othw. processed for spinning, of viscose rayon	25.5	224	198.5	11%
520528	Cotton yarn, single (excl. sewing thread), of combed fibres, containing 85%/more by weight of cotton, measuring <83.33dtx. (>120 metric number), not put up for retail sale	23.2	33.4	10.2	69%
520513	Cotton yarn, single (excl. sewing thread), of uncombed fibres, containing 85%/more by weight of cotton, measuring <232.56dtx. but not <192.31dtx. (>43 metric number but not > 52 metric number), not put up for retail sale	17.5	166.2	148.7	11%
520524	Cotton yarn, single (excl. sewing thread), of combed fibres, containing 85%/more by weight of cotton, measuring <192.31dtx. but not <125dtx.	14.7	898.25	883.55	2%

HS Code	Items	India's exports to Pakistan	India's global exports	Difference between India's exports to Pakistan and its global exports	Share= India's exports to Pak/India's global exports to the world
	(>52 metric number but not >80 metric number), not put up for retail sale				
550921	Yarn other than sewing thread, of synthetic staple fibres, containing 85%/more by weight of polyester staple fibres, single yarn, not put up for retail sale	8.9	50.46	41.56	18%
520512	Cotton yarn, single (excl. sewing thread), of uncombed fibres, containing 85%/more by weight of cotton, measuring <714.29dtx. but not <232.56dtx. (>14 metric number but not >43 metric number), not put up for retail sale	8.8	666.23	657.43	1%
520511	Cotton yarn, single (excl. sewing thread), of uncombed fibres, containing 85%/more by weight of cotton, measuring 714.29dtx./more (not >14 metric number), not put up for retail sale	8.6	289.9	281.3	3%

## Annexure 2: Top 10 T&C imports of India from Pakistan

HS Code	Items	India's imports from Pakistan	India's global imports	Difference	Share=India's imports from Pakistan/India's global imports
		In million USD			(%)
520100	Cotton, not carded/combed	21.4	399.8	378.3	5%
510119	Wool, not carded/combed, greasy, in	9.9	232.8	222.9	4%
631090	Used/new rags, scrap twine, cordage, rope & cables & worn out articles of twine/cordage/rope/cables, of textile materials (excl. sorted)	4.4	49.2	44.8	9%
520942	Woven fabrics of cotton, containing 85%/more by weight of cotton, denim, weighing >200g/m2	4.4	28.2	23.8	16%
510129	Wool, not carded/combed, degreased,	3.9	72	68	5%
520932	Woven fabrics of cotton, containing 85%/more by weight of cotton, dyed, 3-/4-thread twill, incl. cross twill, weighing >200g/m2	3.2	12.4	9.2	26%
521142	Woven fabrics of cotton, containing <85% by weight of cotton, mixed mainly/solely with man-made fibres, denim, weighing >200g/m2	2.7	7.2	4.4	38%
520832	Woven fabrics of cotton, containing 85%/more by weight of cotton, dyed, plain weave, weighing >100g/m2	1.1	24.4	23.3	5%
520528	Cotton yarn, single (excl. sewing thread), of combed fibres, containing 85%/more by weight of cotton, measuring <83.33dtx. (>120 metric number), not put up for retail sale	1.05	40.4	39.3	3%
520931	Woven fabrics of cotton, containing 85%/more by weight of cotton, dyed, plain weave, weighing >200g/m2	0.9	8.2	7.2	11%

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