4 INDUSTRY SPECIFIC OPPORTUNITIES AND THREATS

This chapter elaborates the opportunities and threats in some important sectors in Pakistan which are likely to emerge by the opening up of trade between the two countries. These sectors include: Textiles and Clothing, Iron and Steel, Chemicals and Pharmaceuticals, Automobiles, Small and Medium-sized Enterprises and Information Technology.

Textiles and Clothing

The textile and apparel sector continues to be the driving force for economic growth in both India and Pakistan. The textile and apparel sector in these countries accounts for a significant portion of traded goods, contributing 18.8 percent in India and 65.6 percent in Pakistan, of the total value of exports in FY04. Both these countries are highly dependent on the sector for creation of employment opportunities and export earnings. The dismantling of the quota regime represents both an opportunity as well as a threat: an opportunity because markets will no longer be restricted; a threat because markets will no longer be guaranteed by quotas and even the domestic market will be open to competition.

Presently trade in textile and clothing between India and Pakistan is almost non-existent. Pakistan's total imports of textile and clothing in FY04 stood at $65.3 million (of which 85.6 percent was raw cotton imports), while exports to India stood at a dismal $11.1 million despite the grant of MFN status to Pakistan by India. It is generally apprehended in Pakistan that Indian textile products are cheaper than Pakistani products and hence will flood the domestic market once India is granted MFN status.

In both India and Pakistan, the textile and apparel sectors exhibit different degrees of specialization. While firms in Pakistan are specialized 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. Firms in these two countries generally are not vertically integrated, and are, for the most part, independent, privately owned small and medium sized firms. However, several firms in the textile sector have become vertically integrated in recent years. For example, Pakistani bed linen manufacturers are large, integrated units that continue to upgrade capacity with new machines when needed.

India has inherent strengths in terms of a strong multi-fibre raw material base, low cost of labor, intellectual capital, and dynamic entrepreneurship. In a recent study

published by USITC,[39] India is regarded as a major alternative source to China once quotas are removed for apparel and made-up textile products. The study further stipulates, "Retailers and apparel suppliers acknowledged that India is likely to remain competitive after quota removal because of its large, relatively low cost labor force, a large domestic supply of fabrics, and the industry's ability to manufacture a wide range of products. Retailers describe Indian firms as innovative, particularly in design functions." International brands already present in the market include Benetton, Lacoste, Levi Strauss, Crocodile, Dockers, Lee, Wrangler, Nike, Reebok, Adidas, Zegna, Marks & Spencer, etc. On the other hand, Pakistan is termed as a supplier of limited range of products. However, it is considered a competitive supplier of cotton goods, particularly men's apparel, home textiles, and fabrics.

Composition of Cash Costs in Apparel and Textile Production (%)

	Pakistan		India	
	Apparel	Textiles	Apparel	Textiles
Materials	56.1	82.4	47.8	39.3
Electricity	3.5	3.9	0.9	6.4
Other energy	0.9	0.9	0.9	5.6
Wages	13.9	4.6	11.3	11.2
Benefits	0.4	0.2	0.8	0.9
Sales and general admin	7.2	1.2	2.3	7.4
Transport/Communication	3.7	2.7	28.4	4.3
Other costs	1.1	0.3	3.6	8.5
Interest and rent	13.1	3.8	4	16.4
Total	100	100	100	100
Cash costs as share of sales	54.1	72.3	84	123.8

An international comparison of the cost structure of the textile sector undertaken by the Zurich-based International Textile Manufacturers' Federation (ITMF) reveals that India's production costs are among the highest in the world although it has the lowest labor costs. Labor costs have declined as a percentage of production (7 to 8 percent, down from 12 percent in the 1990s) whereas power and other costs have continued to grow. According to a recent (2003) ITMF study of seven countries, i.e. Brazil, China, India, Italy, Korea, Turkey and USA, power cost is highest in India. Except for woven textured yarn fabric (Italy is highest with 28 percent); the power cost in total cost of spinning, weaving and knitting is highest in India, i.e. in the range of 6 percent to 17 percent.

A recent study on Pakistan's industrial competitiveness[40] and firm-level comparisons suggests that while wages in Pakistan are low by international standards, they are often significantly higher than those in Bangladesh and slightly higher than in India despite it being a low wage, labor surplus economy. The study further contends that allowing for the differences in labor and capital productivity, on average Pakistan is a higher cost location than the People's Republic of China (PRC), India or Bangladesh.

[39] "Textiles and Apparel: Assessment of the Competitiveness of Certain Foreign Suppliers to the U.S. Market", Investigation No. 332-448, U.S. International Trade Commission, Washington, DC 20436, *www.usitc.gov*.

[40] Weiss and Lal, 2004.

An international comparison of cost structures of India and Pakistan is provided by the World Bank Investment Climate Assessment surveys (2001-02). The table below provides an indication of the cost structure of the apparel and textile industries in both the countries.

Comparisons of Input Sourcing in the Apparel and Textile Industries (%)

	Pakistan		India	
	Apparel	**Textiles**	**Apparel**	**Textiles**
Domestic	59	97	94	91
Imported	41	3	6	9

An important source of cost reduction and efficiency improvement in many countries is the use of imported intermediates that are of better quality than domestic substitutes, or at least better suited to the needs of the domestic industry. Pakistan's apparel sector has moved a long way from its traditional pattern of reliance on domestic inputs towards international sourcing of intermediate inputs. The 41 percent share of import contents in the apparel sector in Pakistan is far higher than the 6 percent share in India. Pakistan's textile sector, however, remains strongly linked to the transformation of domestic inputs (97 percent). To participate in the fully-globalize market for textiles and clothing that will emerge after the abolition of the quotas, it seems likely that Pakistan would need a greater degree of international sourcing of textile inputs.

The Age of Capital Equipment, Distribution and Median (%)

	Pakistan		India
	Apparel	**Textiles**	**Textiles**
Age of capital < 5 years	14	22	21
Age of capital 5-10 years	28	23	28
Age of capital 10-20 years	35	42	20
Age of capital >20 years	23	13	26
Median (years)	12	11	11

Comparing the age of capital stock between the textile industries in both India and Pakistan, World Bank in a policy note[41] published in April 2004 observed that the median age of the capital stock in the Indian textile sector was about the same as in Pakistan, at 11 years. The report further pointed out "given the very rapid development of technology in this sector, the greater age of installed capital at the plant level seems likely to provide great scope for raising productivity by modernizing the capital stock in Pakistan. The high rate of investment in Pakistan in recent years may already have reduced this age differential considerably" The report further argued that very low cash costs of production seem to have provided powerful incentives and opportunities for investment in the apparel sector, in particular.

Competitiveness Ranking-(2003)

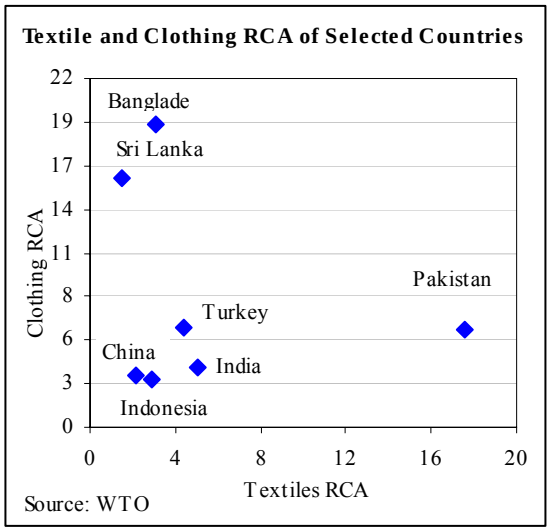
	Growth Competitiveness	Business Competitiveness
Pakistan	73	72
India	56	37
Total Countries	102	96

Source: World Competitiveness Report 2004 (World Economic Forum)

[41] Martin, 2004.

Will Martin (2004) has estimated the average export tax equivalents of the quotas for textiles and clothing for Indian and Pakistani exports to the USA and the EU. It was observed that the export tax equivalents for Pakistani producers are considerably lower, when compared for the same product mix, while the export tax equivalents for India have fallen in recent years, a finding validated by low quota utilization rates.

In terms of overall competitiveness ranking, India is better placed than Pakistan in both growth competitiveness and business competitiveness as indicted by the latest indices computed by the World Economic Forum for the year 2003.



The "revealed" comparative advantage (RCA) index developed by Balassa[42] ranked Pakistan above India in the textiles and clothing sectors. This advantage should be interpreted cautiously[43] as the magnitude of the index also shows the countries' dependence on a particular sector for export earnings. Higher the magnitude, greater will be the vulnerability of export earnings to sector specific events (**Annexure 7)**.

Compared to their Pakistani counterparts, Indian small scale enterprises in the textile sector are better placed due to conscious efforts by the Indian Government, which over the years has facilitated them by granting various concessions through fiscal and infrastructure development policies. SMEs in India mostly operate in clusters and enjoy tax and excise benefits. Most importantly, until 2001, the Indian Government had kept domestic woven and knitted apparel market reserved for the small scale industrial producers.

Since the specific price data for both Indian and Pakistani textile products are not available, export unit value could be a good proxy for their comparison. An analysis of trade data at the 8-digit HS Code level reveals that India exported 1,702 textile products to the rest of the world during FY04 compared to only 633 products exported by Pakistan. The comparison of exports of both Pakistan and India identifies 176 common

[42] Balassa's (1965, 1979) RCA index compares the export share of a given sector in a country with the export share of that sector in the world market. RCA has extensively been used as a mean to consider the intrinsic comparative advantage of a particular export commodity. Values above one indicate that the country is specialized in the sector under review.

[43] RCA calculated on the basis of 2003 data also reveals that Pakistan's textile exports occupied top position (among 36 countries for which comparable trade data is available), while it ranked sixth in clothing exports (among 38 countries).

items which have comparable unit values. Out of these 176 items, India has a price advantage, i.e. lower realized export unit value in 48 textile products while Pakistan has price advantage in 128 textile products (**Annexure 8**). Since other factors like quality, production and design of products, etc., are also important, it is hard to conclude on the basis of just export unit value that granting of MFN status will result in a uni-directional flow of textile products, i.e. Indian products flooding the domestic market of textile products.

Pakistan's economy is far less diversified as compared to the Indian economy and depends heavily on the textile industry. Despite Government efforts to widen the industrial base and diversify exports, the industrial sector remains dominated by the textile sector. Unless efforts are made to rectify this situation, granting unrestricted access to Indian textiles in Pakistani domestic market may have serious repercussions for the whole economy. It is a well established fact that free trade leads to greater benefits to consumers in the form of lower prices due to increased competition. Similarly, despite facing losses in the short run, producers also ultimately gain through greater market access and improved efficiency in the long-run.

Based on an analysis of market conditions and trade policies in the two countries, a recent study[44] conducted by the World Bank concluded that restoration of normal trade relations in textile and clothing would likely have a small but beneficial impact on both India and Pakistan. Eliminating all barriers to intra-regional textiles and clothing trade would likely induce some limited specialization and trade in intermediate inputs for use in exports to high-income countries. The study further claimed that preferential liberalization of textiles and clothing trade under SAFTA would increase overall economic welfare without any significant trade diversion, since both Pakistan and India are already very competitive.

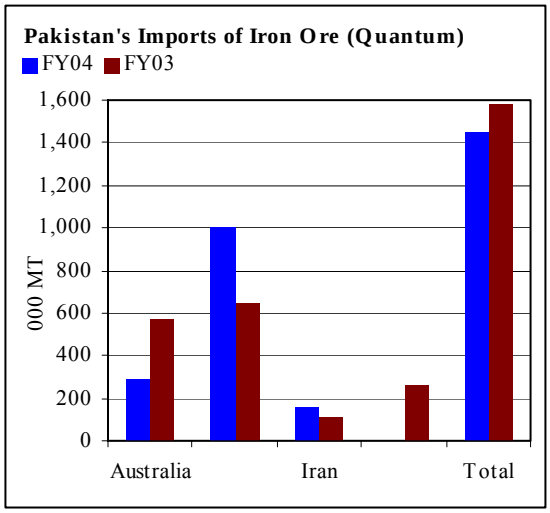
The study also claimed that preferential access to each other's fabric markets under SAFTA is a priori of more interest to Pakistan than to Indian textile firms. In contrast to heavily export oriented textile fabric production in Pakistan (75 percent of total production is directly or indirectly exported while 25 percent is sold in the domestic market), only 23 percent of Indian fabric production is directly or indirectly exported and domestic market is much larger both in absolute terms and relative to production. With normal trading relationships and an FTA there would be some possibilities for Indian exports to higher income Pakistan consumers based on the Indian advantage in finer fabrics using higher count cotton yarns[45] and in design, and to low income Pakistan markets based on Indian advantages in synthetic textiles, especially filament consumer fabrics.

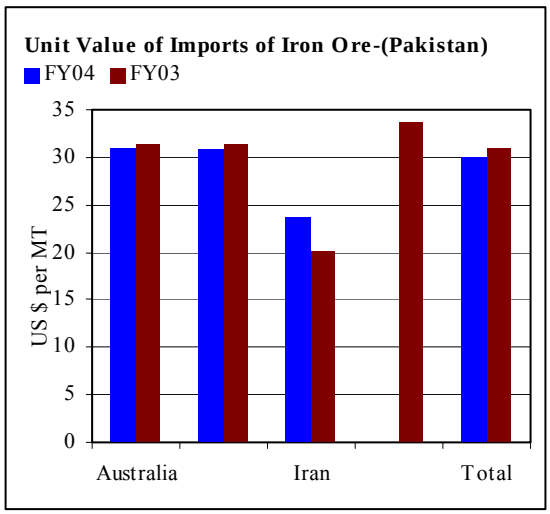
[44] Pursell, 2006.

[45] Pakistani cotton is short staple and is best suited for low count (coarse) yarn while India has a much higher proportion of medium and long staple cotton which is used to produce higher count yarns.

However, the importance of textile sector for the Pakistani economy in terms of foreign exchange earnings, employment, etc. requires careful assessment of the likely impact of granting MFN status to India.

Iron and Steel





Iron and Steel Industry provides basic raw material for the engineering industries and construction /infrastructure sectors. Developments in this vital sector generally reflect the overall economic growth in the country. Shortage of essential raw material (iron ore) hampered the development of this important industry and the country is forced to fulfill its domestic requirements through import of iron & steel and its products. Pakistan Steel with a production capacity of 1.1 million tons of raw steel per annum, with a built-in potential to expand capacity to over 3 million tons per annum, is the first integrated iron & steel works project in Pakistan, which was established to enhance domestic availability. It produces a wide range of products including coke, pig iron, billets, hot rolled coils/sheets, cold rolled coils/sheets, and formed sections like channels, angles, galvanized sheets, etc. However, its production is largely dependent on imported raw materials, i.e. iron ore.

During the last two years, India was the major source of raw material (iron ore) to this vital industry. In FY04, imports from India accounted for 69.2 percent of the total imports (iron ore concentrate and manganese ores and concentrates), compared to 40.6 percent in FY03. The other suppliers of iron ore were Australia (19.9 percent) and Iran (10.9 percent). However, the average import unit value of Indian iron ore during FY04 was slightly higher than the average import unit value of total iron ore imports, primarily due to the

considerably cheaper imports from Iran. It is therefore unlikely that imports from India would be able to maintain its dominating supplier status. Moreover, there is not much room for increasing imports from India in the near future on account of the need to diversify the source of raw material for this important sector.

Unlike Pakistan, India has a well-established steel industry and is a net exporter of steel and steel products. On the back of abundant raw materials,[46] highly skilled technical manpower and competitive labor, India is the eighth largest crude steel producer in the world[47] and largest producer of sponge iron in the world with production of 8.00 million tons in 2003-04. The total finished steel production in India stood at 36.19 million tons during 2003-04. On the basis of routes of production, the Indian steel industry can be divided into two types of producers: a) Integrated Producers that convert iron ore into steel; and b) Secondary Producers, the mini steel plants that make steel by melting scrap or sponge iron or a mixture of the two.

Indian steel industry produces a whole range of steel products, i.e. pig iron, sponge iron, hot rolled coils/ sheets[48] (used in automobiles, engineering and consumer durables, while sheets are used in LPG cylinders, tubes, pipes, drums, auto components, ship building and boilers), cold rolled coils/ sheets (used for manufacturing coated sheets, automotive sector and white goods sector), galvanized sheets (used in fabrication work like car bodies, ducts, consumer durables and roofing), long products (includes bars, structural products, wire rods, angles and rounds, used in construction and heavy engineering), and alloy steel products (value-added steel for specific application, used in auto components, ball bearing, engineering items, springs, boilers, utensils).

Indian iron & steel products are freely exportable and exports have shown a significant increase during last few years. However, Pakistan's iron and steel product imports from India during FY03 and FY04 were just a small fraction of its total imports. In FY04, Pakistan imported a total of $62 million worth of iron and steel products (326 items) of which India supplied only 25 items worth $7.1 million. Out of 25 items imported from India, 13 items had lower unit value of imports compared to the unit value of the same items imported from elsewhere. These items may be identified as the potential imports of iron and steel products from India. Similarly, additional import items could also be identified by comparing Pakistan's import of iron and steel products from the rest of the World with the Indian export of iron and steel products to the rest of the world. Using the HS Code at eight-digit level, about 46 items are identified as potential imports that are cheaper to import from India on the basis of lower unit value

[46] India ranks sixth and accounts for about 6 percent of total global production of iron ore.

[47] China remained the world's largest crude steel producer in 2003 (220.12 million metric tons) followed by Japan (110.51 million metric tons) and USA (91.36 million metric tons). Source: International Iron and Steel Institute, USA.

[48] As per the ratings of "World Steel Dynamics", Indian HR Products are classified in the Tier-II category quality products. EU and Japan have qualified for the top slot, while countries like South Korea, USA share the same class as India.

of Indian exports compared to the import unit value of Pakistan's imports from the rest of the world (**Annexure 9 & 10).**

Chemicals and Pharmaceuticals[49]

The chemical industry is a key contributor in the economic development of any country. Pakistan's chemical industry has by and large developed on a fragmented and ad-hoc basis, motivated by a combination of the existence of a small local market and traditionally high tariffs. As a result it suffers from the lack of economies of scale, national integration and consequent un-competitiveness. Resultantly, the country is highly dependent on imported chemicals to cater for the needs of its agriculture as well as industrial sectors. Since Pakistan is an agricultural economy, major part of the chemical industry provides agricultural inputs, i.e. fertilizer and pesticides. During FY04, the total imports of chemicals (fertilizers, insecticides, plastic materials, medicinal products, and other organic and inorganic chemicals) stood at $2.8 billion, an increase of 29.5 percent over the last year.

Sectors in which some economies of scale and integration have been achieved on the basis of a growing local market include fertilizers, pesticides and to some extent dye-stuffs and other inputs for the textile industries. The production of pesticides and dye-stuffs are primarily based on imported base materials and the domestic value addition is confined to formulations and packaging.

Chemicals are divided in two main categories from the value addition point of view. Those produced in large and bulk quantities but with lower value addition are called commodity chemicals such as fertilizers and soda ash, etc. Specialty chemicals are those produced in smaller quantities with higher value addition, i.e. dyes and pigments, pharmaceuticals and enzymes, etc

Compared to Pakistan, the Indian chemical industry is well-established and has shown impressive growth over the years contributing about 6.7 percent in the Indian GDP. The industry is a vital part of the agriculture and industrial development in India and has key linkages with several other downstream industries. In terms of volume, it is the twelfth largest in the world,[50] and third largest in Asia. With a current turnover of about US $30.8 billion, it accounts for 14 percent of the total manufacturing output in India. During the last five years, it grew at twice the rate of growth in Asia and five times the world growth for the sector. India is becoming the laboratory of the world for the global chemical industry and leading global players like Dow Chemicals, DuPont, and General Electric have set up their own laboratory or using Indian laboratories.

The chemical industry in India comprises many sectors i.e. organic/ inorganic chemicals, dyestuffs, paints, pesticides, specialty chemicals, etc. Main individual

[49] This section draws major information from the Supply survey on pharmaceutical products-Pakistan (November 2004), South-South Trade Promotion Program, UNTACD/WTO and various sector reports available on the internet.

[50] The global chemical industry is estimated at about US $1.7 trillion.

chemical industries are caustic soda, soda ash, carbon black, phenol, acetic acid, methanol and azo dyes. India is currently the largest manufacturer of pesticides and the second largest producer of agro chemicals in Asia. India is also the third largest fertilizer producer in the world. Besides the presence of major world manufacturers such as Unilever, ICI, Hoechst, DuPont, BASF, Bayer and Glaxo, there are thousands of large, medium and small-scale companies in the sector.

In a recent case study on the caustic soda industry,[51] the authors employing welfare gain/loss analysis concluded that Pakistani producers of export-oriented downstream industries, including textiles, food and beverages, soaps, vegetable oil, fertilizer, etc., would benefit under a free trade arrangement by getting cheaper caustic soda from India

The pharmaceutical industry in Pakistan also plays an important role in the economic development of the country by ensuring better health to the people through supplying cheaper and quality drugs. Total local production/consumption of pharmaceuticals is presently estimated at $2.0 billion.[52] There are about 316 pharmaceutical manufacturing companies including 30 multinationals (47 percent share), which are meeting around 80 percent of the country's requirement. Total capital investment in this sector is Rs 21.12 billion divided almost evenly between national and multinational companies. Most of the pharmaceutical manufacturing units are ISO certified. Almost 95 percent of the basic raw materials used for manufacturing of medicines are imported from China, India, Japan, United Kingdom, Germany, Netherlands and others. Other production inputs, i.e. technology, labor, packaging materials, power and raw materials are easily available and Government provides good incentives for importing raw materials and technology.

The leading categories of pharmaceutical products manufactured in Pakistan consist of systematic anti-infective, anti-rheumatic, non-steroidal and broad-spectrum penicillin. Several factors such as inconsistent and discriminatory policies, lack of funds for upgrading the plants, high duties in the formulation industry, lack of R&D facilities,[53] unavailability of sophisticated machinery, high cost of inputs, and stringent price controls have affected production in the pharmaceutical industry. However, there has been a substantial increase in investment in the formulation industry to improve quality and to increase capacity.

Compared to the pharmaceutical industry of India, the size of Pakistani companies is relatively small and hence uncompetitive. The Indian pharmaceutical industry has become a net exporter and is now putting up USA (FDA[54]) approved plants and is exporting to advance economies. They have also integrated backwards and invested heavily in basic manufacturing and Research and Development to become globally

[51] Ahmad, Farooq and Zaman, in Naqvi and Schuler 2006.
[52] Global sales of pharmaceuticals are estimated at US $317.2 billion of which Pakistan's share is 0.31percent.
[53] It is a knowledge-based industry requiring significant investment in research and development.
[54] Food and Drugs Administration.

competitive. In some pharmaceutical raw materials, the Indian companies are the only suppliers worldwide.

The Indian pharmaceutical industry has shown tremendous progress in terms of infrastructure development, technology base creation and a wide range of production. The Indian industry now produces bulk drugs belonging to all major therapeutic groups. Strong scientific and technical manpower and pioneering work done in process development have contributed to this. The country ranks fourth worldwide accounting for 8 percent of world's production by volume and 1.5 percent by value.

India is also among the top twenty pharmaceutical exporters and among the top five manufacturers of bulk drugs in the world. The industry manufactures almost the entire range of therapeutic products and is capable of producing raw materials for manufacturing a wide range of bulk drugs from the basic stage. Over 60 percent of India's bulk drug production is exported and the balance is sold locally to other formulators. With more than 85 percent of formulation production in the country sold in the domestic market, India is largely self-sufficient in the case of formulations, even though some life-saving, new-generation, and under-patent formulations continue to be imported. It is the largest producer of Sulfamethoxole and Ethambutol (anti TB).

Indian pharmaceutical Industry has the advantages of self-reliant technology for production; innovative scientific manpower; low production costs; low R&D costs; easy availability of raw materials and well-developed capital equipment. Many units are approved by regulatory authorities in USA and United Kingdom. However, it is highly fragmented with about 22,000 players; the organized sector comprises about 260 players and the top ten companies account for one-third of the market. Formulations account for about 80 percent of this market while the rest is made up of bulk drugs.

Structure and dynamics of the Indian pharmaceutical industry are unique primarily on account of the following facts: 1) The process patent regime 2) Price controls; and 3) Exemptions to Small Scale Industries (SSIs). Industrial licensing has been abolished except for production of recombinant DNA technology, bulk drugs requiring in-vivo use of nucleic acids as active principal and specific cell-tissue targeted drug formulations. FDI up to 100 percent is permitted on the automatic route for manufacture of drugs and pharmaceuticals (provided the activity does not attract compulsory licensing or involve use of recombinant DNA technology, and specific cell/tissue targeted formulations). Imports of drugs and pharmaceuticals are allowed freely, except those in the restricted list of import under the current Exim Policy, which can be imported under an import license. Indian pharmaceutical products are being exported to a large number of countries including USA, Canada, Germany, France and Latin American countries. Major products exported are anti-infective (including antibiotics), anti-bacterial and anti-tuberculosis drugs.

During FY03 and FY04, Pakistan imported 4.3 percent and 6.8 percent of its total imports of chemical and pharmaceutical products respectively from India. Out of total imports of $2.9 billion (1105 items) in FY04, India supplied 353 items worth $196.8 million. Out of total imported chemicals and pharmaceutical products from India, 166

items had a lower unit value of imports compared to the unit value of the same items imported from elsewhere. These items have the potential for enhancing imports from India.

Automobiles

The automobile industry in Pakistan operates under franchise and technical cooperation agreements with leading world manufacturers and can be broadly categorized into various segments, i.e. cars and light commercial vehicles (LCVs), two and three wheelers, tractors, trucks and buses and vendor industry.

The importance of auto industry in the Pakistan economy can hardly be over emphasized. The vehicle manufacturers alone employ around 10,000 workers with more than 100,000 people working in the vendor industry. Presently, the automobile Industry mainly comprises of more than a dozen manufacturers of passenger cars, commercial vehicles, motorbikes and tractors, and over 800 down stream vendors supplying various indigenous component to these Manufacturers. During the FY02-03 the automotive industry contributed over Rs 30 billion to the government exchequer in the form of duties and taxes, with a contribution of Rs 17 billion from the top four manufacturers alone.[55]

From the late 80s to the early 90s the demand for automobiles in Pakistan was on the rise, setting the stage for a decade of robust growth. The demand has risen substantially after September 11, 2001, partly in the wake of the increase in home remittances which resulted in greater liquidity in the market. Consumer financing, particularly by the larger commercial banks, has played an important role in supporting the demand for automobiles. In order to meet the rising demand, the automobile industry has increased its production considerably. The industry has achieved a phenomenal growth of 50.2 percent in FY04 even over the very high base due to a 46.6 percent rise in production during FY03.[56]

Compared with Pakistan, India has a strong engineering base and has successfully created a sizable capacity for production of vehicles. It enjoys a clear edge over Pakistan in the automobile sector. Indian auto companies are highly cost competitive due to appropriate levels of automation and low cost automation and have achieved a high level of productivity by embracing Japanese concepts and best practices. India is already the second largest two wheeler manufacturer in the world, second largest tractor manufacturer in the world, and fifth largest commercial vehicle manufacturer in the world and fourth largest car market in Asia.[57] The automobile industry in India is now gradually evolving to replicate those of developed countries.

[55] Yousaf, *Pakistan and Gulf Economist*, April 12-18, 2004.
[56] SBP Annual Report 2003-04.
[57] Indian Automotive & Auto Component Industry: Status Report, Automotive Component Manufacturers Association of India (ACMA). http://acmainfo.com/.

As regards auto trade with India, there is a lurking fear in Pakistan that free trade with India will adversely affect our automobile sector particularly its two wheelers, as Indians are presently marketing these items at much cheaper rates.[58] Many assemblers feel that the local industry will suffer due to opening of trade with India in case the cost of doing business in Pakistan is not brought down in due course of time. Pakistani auto-parts industry is only interested in the procurement of raw materials from India instead of seeking any technical collaboration or the transfer of technology. However, Pakistan can import automotive components and spare parts from India at a lower price as presently these items are being imported from Far East at higher prices. On the other hand, India is expected to benefit from free trade due to its low raw material, electric and labor costs.

Small and Medium Enterprises (SMEs)

SME sector is an important sector in the economy of Pakistan. According to Small & Medium Enterprise Development Authority (SMEDA), more than two million small and medium enterprises (SMEs) spread across the country contribute 30 percent to GDP and generate around 25 percent of the manufacturing sector's export earnings. The SMEs constitute 90 percent of the business and are responsible for 80 percent of non-farm based employment. However, the competitiveness of the SMEs is marred by their structural weaknesses and to some extent insufficient institutional support from the government. Over 90 percent SMEs are very small in size, both in terms of investment and workforce. Consequently, they are fraught with various problems ranging from their smaller size to higher production costs, lack of access to easy and cheap finance, modern technology and capital goods, non-availability of local raw material, lower productivity, etc. Moreover, expensive labor, skill gaps and a flawed tax structure have also impeded their growth. A Small and Medium Enterprise Bank has been established to provide program loans, new credit appraisal and documentation techniques to assist the SME financing needs. Since most of the SMEs in Pakistan cannot be categorized in the documented formal economy, these units can neither have access to finance to support their production capacity nor to upgrade their technology to improve efficiency and productivity. This has resulted in higher input and production costs as well as a lack of efficiency and competition. All these problems weaken Pakistan's SMEs sector in the South Asian region.

On the other hand, India has a strong industrial base and its small-scale sector has grown phenomenally during the last three decades. Small and medium-sized enterprises are considered to be one of the principal driving forces of economic development in India. The significant role of Small Scale Industries (SSIs) in the Indian economy is reflected by fact that presently these account for 95 percent of all industrial units in the

[58] Freer Trade with India – Its Raison D'etre and Impact: KCCI Report 1996.

country and contribute 40 percent of the total output. About 7,500 products are manufactured in the small-scale sector with export share to the extent of 35 percent.

The Government of India has always accorded priority to the Village and Small Industries Sector in its Industrial Policy Resolutions and for industrialization strategy. The State has played a progressively active role in the development as well as strengthening of small-scale industries through various measures. In this regard, a full fledged Bank namely the 'Small Industries Development Bank of India' (SIDBI) is functioning as an apex institution for promotion, financing and development of industries in the small scale sector and for coordinating the functions of other institutions engaged in similar activities. These policy measures have given thrust to the simplification of regulations and procedures, economic viability of SSI units, improving their competitive strength, export promotion, credit flow and development of integrated infrastructure for the sector.

What will happen to Pakistan's small and medium business sector once trade with India is further opened up and moves towards freer trade between the two countries? In this connection, no specific study has so far been conducted to analyze the possible implications of free trade on regional SMEs. It is, however, generally believed that India is one of the most protected economies and its industrial base is stronger than Pakistan. It would be difficult for Pakistani SMEs to compete with Indian SMEs under existing conditions. Most of the small and medium entrepreneurs are of the view that SMEs in Pakistan do not have the kind of strength that they need to compete in a free-trade environment. SMEs in Pakistan are already grappling with numerous structural and institutional weaknesses and will be the most vulnerable sector if free trade starts between Pakistan and India. Some (efficient and cost-effective) SMEs would survive while others won't, which will result in plant closures and unemployment. Only those industries would be able to hold out against Indian products which are already catering to export markets. On the other hand, some entrepreneurs view the prospect of liberalization of trade as a window of opportunity to improve production quality and efficiency through greater exposure to regional competition especially with India. This idea is supported by the fact that the exporting industries of readymade garments, knitwear and hosiery have already achieved a minimum level of efficiency and are now reasonably competitive. Only those industries marketing their products domestically with no potential for exports will face the problem.

In view of the foregoing, there is an urgent need to address all the issues facing the SMEs in Pakistan, and to formulate a policy framework along with a conducive regulatory environment before entering into free trade with India. The SMEs need a lot of financial and technological support from the government to sustain and compete in a free trade era. The solution lies in technology up-gradation, modernization, and emphasis on core competencies and promoting clusters/industrial estates.

Information Technology (IT)

Information Technology (IT) is the top priority and a sunrise industry in the global arena. The entire South Asian economy is also being propelled by the services sector, in particular by knowledge-based industries. A large number of Indian, Pakistani and Sri Lankan IT professionals are active in Europe and America. Starting from a low level of $4 million in 1980, Indian software exports have reached US $8 billion in FY03. By 2008, India's software industry is expected to cross US $87 billion, with $50 billion coming from exports.[59]

In India, the IT industry has made tremendous progress and has emerged as one of the fastest growing sectors. The Government of India has recognized IT as a priority sector for the growth and development of the country and has therefore, formulated strategic policies and provided incentives for its advancement. A large number of Indian software companies have not only acquired international quality certification but also enjoy a comparative advantage in IT-enabled services. A majority of the multinational companies operating in the area of information technology in India have either software development centers or research development centers. India's expertise in emerging technologies has actually helped the country to get new customers and the companies in Europe and Japan are directing their outsourcing to India.

In Pakistan, the IT industry is in its infancy but is growing at an enormous pace while struggling to catch up with the regional and global industry. According to Pakistan Software Houses Association (PASHA), Pakistan is currently home to around 300 IT and BPO companies, who generate around $50 million revenues annually. At present, the industry employs around 10,000 professionals. However, most of the companies are small to medium sized with a little representation of entities having full concentration in the export of software and IT-enabled services.

Pakistan has lagged dangerously behind other regional countries in exploiting IT as a catalyst for economic revival. However, the significant growth of the Internet and the coming tidal wave of E-Commerce still provide immense opportunities for Pakistan to exploit their potential and use them for accelerating its economic revival. Though the software industry is growing at an accelerated pace in Pakistan, the fledging Pakistani industry is unlikely to provide serious competition to the enormous Indian industry once trade is further liberalized. However, this is one of the potential areas which could be exploited, and business-to-business links can be cultivated for mutual advantage both for Pakistan and India.

There is a need to enhance business opportunities and help National Association of Software and Services Companies (NASSCOM) and PASHA, the apex bodies representing the Indian and Pakistani IT software and service companies, to put together a framework of mutual co-operation for continuous interaction between the

[59] USA and South Asia in the New Millennium in QJIRS (2004), Islamabad, Pakistan.

two countries in the IT sector. The Pakistani IT industry can look at Indian experiences and learn from them in putting up businesses in cooperation with each other. India with its wider software Industry can extend help to Pakistan to promote IT through the establishment of joint ventures. In this connection, the major players in the Indian IT sector may be approached for possible joint ventures**.**