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Pakistan-India Trade

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Abstract

With the invitation on 5 August 2011 from the Indian commerce minister to his Pakistani counterpart to visit New Delhi and hold substantive talks on improving trade relations between the two countries, groundwork may be laid for breaching the differences that have created enormous burdens of history. Trade is a good place to start but, as discussed in this brief, some serious work will needs to be done before real progress can be made.

Introduction

If there is to be a thaw in Pakistan-India relations, trade is the best place to start. Those who know their history realise that at the time the two countries became independent, India was Pakistan's largest trading partner. In 1948-49, 70 per cent of Pakistan's trading transactions were with India, while 63 per cent of India's exports went to Pakistan.[2] The basis for this active trading relationship was set by the British when they decided in the second half of the 19th century to turn the virgin lands of central and southern Punjab and southern Sindh into food granaries for the deficit provinces of the northeast. These provinces had suffered repeated famines resulting in the loss of millions of lives through starvation. The colonial power had become anxious lest this heavy human toll created a security problem for their rule. The British then were recovering from the mutiny of 1857 and they did not want a repeat of that experience. Not only did they bring surface irrigation to the plains of Punjab and Sindh by tapping the Indus River system, they also constructed an elaborate system of

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2 Mohsin S. Khan, 'Improving India-Pakistan relations through trade', *East Asia Forum* (19 April 2010), p. 1.

transport to take surplus food grains to the deficit areas. As a result of what the colonial power did to the areas in the northeastern and northwestern parts of their domain, the Pakistani economy was tied closely to that of India when the two countries gained independence.

That would have remained the case had a series of quarrels between the two newly independent states not resulted in the severance of trade. India imposed a trade embargo on Pakistan in 1949 when the latter refused to devalue its currency with respect to the United States (US) dollar. This was done by other countries of the British Commonwealth. The embargo was a transformational experience for Pakistan. From being a primarily agricultural economy, Pakistan quickly acquired an industrial base. It also developed new markets, mostly in distant places, for its products. First Japan and then the US became important markets for Pakistan while the commercial exchanges with India became insignificant. This development went against what economist call the 'gravity model of trade'. According to this the largest trading partners should be those that are relatively close in terms of distance and also have large markets. According to the model, China and India should be Pakistan's largest importers and exporters, not the US and the European Union. The potential of Pakistan-China trade may be realised as a consequence of what the two countries call an 'all weather friendship'.[3] The heavy burden of history, however, continues to weigh on the development of trading relations between Pakistan and India.

The potential for trade is enormous, not surprising considering the history of economic relations between the two parts of the British Indian Empire. A recent study using the Pearson Institutes for International Economics gravity model suggests that India-Pakistan trade could expand from its current level of less than US$3 billion to US$42 billion within a few years. However, for this to happen, normal relations assumed by the gravity model should develop between the two countries. This may come about as a consequence of the talks that have begun between the two countries in recent months.

Counter-factual history is a fascinating subject, but it does not lend itself to rigorous analysis. What would have happened to the Pakistani economy had trade links between the two countries remained intact? One can speculate but whatever assertions are made would be contested. What we do know though is that if trade was to resume without constraints, gains to Pakistan would be higher than those for India. There would also be large returns for Pakistan if transit trade between India and Afghanistan and points beyond was to be allowed. In other words, the push for removing trade barriers that continue to inhibit the movements of goods and services between the two countries should come from Pakistan. Islamabad should continue to press for Indian cooperation in this area even if New Delhi, as discussed below, prefers to follow what is sometimes called the 'Look East' policy.

[3] See Iftekhar Ahmed Chowdhury, 'China-Pakistan Relations: Evolution of an "all weather friendship"', ISAS Insights No. 125, 19 June 2011.

Start of Negotiations

It is a good indication of the current Indian mood that on 5 August 2011, Anand Sharma, the country's commerce minister, invited his Pakistani counterpart, Makhdoom Amin Fahim, to visit New Delhi for discussions on trade matters. These follow on the talks held in New Delhi between the foreign ministers of the two countries on 27 July, and the discussion between the two commerce secretaries a few months earlier. In both sets of discussions, it was agreed that trade should be given considerable importance.

There are indications that these talks will focus on half a dozen issues. The first of these is the grant of the 'most favoured nation' status by Pakistan to India. Pakistan is obliged to do that under the World Trade Organization (WTO)'s rules for its members. Its reluctance to fulfil this obligation is hard to understand. I once raised this issue with former President Pervez Musharraf who explained that the term did not translate well in Urdu. By calling India 'nahet pasindeeda mulk' (most favoured nation), he said, would not win him many friends in the highly nationalistic Urdu-medium press. But a lot of water has flowed under many bridges since then and public opinion has certainly softened in Pakistan about its relations with India. Pakistan's business community also wants trade to be conducted with India without too many constraints. It rightly views with favour the many advantages of being able to reach the vast Indian market – a market that is also rapidly increasing in size.

Issues to be Addressed

What are the issues that Pakistan should raise with India? Islamabad should focus on at least four issues. The first of these is non-tariff barriers that India uses not only against Pakistan but against most other countries. Some of these are allowed under WTO rules. India has been one of the more aggressive countries to make use of the anti-dumping provisions of WTO. These may be used in case Pakistan's exports to India increase rapidly.

The second issue is cross-border land trade. As trade economists point out, trade facilitation is the best way to promote commerce. All of South Asia followed the import substitution approach to economic development for about 40 years after the British left the subcontinent. Tariffs were kept very high to encourage domestic production. However, that began to change in the early 1990s as all South Asian countries began to lower their tariff walls. As Gary Pursell, a well regarded trade economist, points out in a recent article, 'during the 1997/7 to 2002/3 trade liberalisation period, Pakistan's tariffs were gradually reduced: the average came down from 42 per cent to 17.3 per cent'. Indian tariffs went in the same direction but from a higher level compared with Pakistan's to a level much lower. In India's case, the decline was from 89.6 per cent in 1982/83 to only 9.8 per cent in 2007/08[4]. With low tariffs there will not be much benefit if they are further reduced as is the aim of the South Asia Free Trade Area Arrangement (SAFTAA).

Since the trend began in lowering tariff barriers, there is much to be gained by easing the restrictions the countries impose on their borders. The drama that takes place on the Wagah border with India is well-known. But this is not restricted to the 'lowering of the flags' ceremony that is conducted each evening by the two sides. There is also drama when the goods that flow from one country to the other are moved from the lorries that have taken them to the border to the lorries that will take them to the other side. Each country should allow lorries from the other side to transport the goods to their intended destinations. This will save both money and time: the latter is important for perishable commodities for which there is considerable scope for a profitable exchange for both countries.

There are a number of other trade facilitation steps the two capitals could take. Most of these relate to the transport of goods and add significantly to the cost of doing business. These include easing restrictions on visas; doing away with the requirement that ships carrying goods from one country to the other must touch a third-country port before proceeding on to their final destinations; requiring that railway wagons carrying goods between the two countries must return empty; restricting the number of crossing points between the two countries to no more than two or three; and restrictions on the opening of bank branches in each other's country.

The third issue concerns investments by the two countries in linking their physical infrastructures. As discussed above, a significant amount of investment was made by the British in developing communication links between the areas that were to become India and Pakistan. For the potential to be realised in developing trade, rail and road links need to be restored and air links improved. Their electricity grid systems should be connected so that the two countries can trade power when there is surplus on one side and shortage on the other. It would also help if an agreement could be reached to extend to India the gas pipeline being built to connect Iran with Pakistan. All these developments will need a fair amount of capital which should be available from the World Bank and the Asian Development Bank.

The fourth issue concerns the revitalisation of SAFTAA. This was negotiated in January 2004 at a summit of the countries belonging to the South Asian Association for Regional Cooperation (SAARC). It became effective in July 2006. However, both India and Pakistan have shown considerable lack of enthusiasm for the agreement. India would rather focus on

[4] Garry Purcell, 'Trade policies in South Asia', in Raghbendra Jha (editor) *RoutlelgeHandbook of South Asian Economics*, London, Routledge, 2011, p. 228.

what it calls its 'Look East' approach to developing trade relations[5]. New Delhi seems more interested in working with the ASEAN (Association of Southeast Asian Nations) countries. It is assigning a relatively low priority to cementing strong economic relations with the countries in its immediate neighbourhood. On the other hand, Pakistan's policymakers have been too distracted by other matters to pay much attention to SAFTAA. This is unfortunate. There is enough empirical evidence available from other parts of the world – from Europe and Latin America, for instance – to suggest that regional associations are a good way of developing trade among the countries that have long been rivals.

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[5] Some analysts have suggested that the 'Look East' policy has little to do with South Asian politics and that it has evolved over many centuries. In fact the current Indian interest in looking east is the fourth phase in the development of relations that began in 12th and 13th centuries. See S.D. Muni, 'India's "Look East" policy: The strategic dimension', ISAS Working Paper No. 121, 1 February 2011.