

ISAS Insights

No. 271 – 21 November 2014

Institute of South Asian Studies
National University of Singapore
29 Heng Mui Keng Terrace
#08-06 (Block B)
Singapore 119620
Tel: (65) 6516 4239 Fax: (65) 6776 7505
www.isas.nus.edu.sg
<http://southasiandiaspora.org>



Indo-Pak Trade and Political Balance

Chandrani Sarma¹

Introduction

Throughout history, improvement in political relations between nations tends to result in better bilateral trade and vice versa. Take famous examples of neighbouring countries like Brazil-Argentina, France-Germany. Total bilateral trade between Brazil and Argentina is more than US\$ 30 billion today. Brazil accounts for the largest share of Argentine imports and Argentina is the third-largest importer from Brazil, behind only the United States and China. These two countries that today share very close ties over trade, culture, and tourism were once at war nearly two centuries ago. France and Germany at war with each other, even before the World wars, decided to let go of enmity in the 1950s. Now, Germany is France's most important trading partner with bilateral trade worth some EUR 161 billion in 2012.²

Trade can also be seen among countries that share huge borders among themselves. The longest international border in the world, between the United States and Canada, is of 8893

¹ Ms Chandrani Sarma is Research Assistant at the Institute of South Asian Studies (ISAS), an autonomous research institute at the National University of Singapore. She can be contacted at isaschsa@nus.edu.sg. Opinions expressed in this paper, based on research by the author, do not necessarily reflect the views of ISAS.

² Federal Foreign Office, Germany. Available at: http://www.auswaertiges-amt.de/EN/Aussenpolitik/Laender/Laenderinfos/01-Nodes/Frankreich_node.html

km. In economic terms, it translates into Canada being the US's largest goods trading partner. Table 1 ranks some of the countries that share some of the longest international borders and the bilateral trade between them.

Table 1: Trade volume between neighbouring countries

Rank	Countries	Border length (in km)	Trade (2013, in US\$ billions)
1	United States - Canada	8893	632
2	Russia - Kazakhstan	6846	28.5
5	India - Bangladesh	4096	6.6
6	China - Russia	3645	88
9	China - India	3380	65.8
10	United states - Mexico	3141	506.7
11	India - Pakistan	2900	2.6

Source: CIA World Fact book

India - Pakistan share the 11th longest international border in the world. Yet, India with a population of 1.2 billion and Pakistan with a population of 196 million had a miniscule bilateral trade of US\$ 2.6 billion in 2013. Sporadic exchanges of fire along the border are quite commonplace, and the recent spat has also resulted in civilian casualties. Trade talks and events have been cancelled, and trade flows have also suffered a blow.

So is the reverse possible; can trade change the political scenario? Trade potential between the two countries has been estimated to be **fifteen times** its current value³, but it is yet to pick up because of major setbacks. If there are gains from trade for both the countries, it may lead to bigger peace constituencies automatically developing. This paper sheds light on these recent trade trends in South Asia, focusing mainly on India and Pakistan and delves deeper into their current trade relations and potentials.

³ "Pak-India Trade Still a Fraction of \$40 Billion Potential," *Express Tribune*, March 13, 2012, <http://tribune.com.pk/story/349146/pak-india-trade-still-a-fraction-of-40-billion-potential/>.

Gravity Model

Analogous to Newton's Law of Gravity, the Gravity model of trade relates the trade flow between two countries to the size of their economies as well as the distance between them.⁴ This would imply that, ceteris paribus, trade would flow mainly between neighbouring countries and to rich countries.

Till a few years ago, the supply chain story was pretty simple; the developing countries exported largely to the developed countries where demand was high. Now, that is slowly but surely changing; and the development of the middle-class is an important factor in these shifting trade flows.

India is witnessing a rapid shift in export destinations from the developed countries like the United Kingdom and the US to Asian countries like China and Singapore. A publication on India's trade and investment by Exim Bank highlighted that overall Asia's share in India's exports increased from 40.2% in 2001-02 to 51.6% in 2011-12 while Europe's declined from 24.8% to 19% in the same period. Though, it can be argued that the US is still one of the top export destinations for India, its share in India's total exports has been falling from 21% in 2001 to 17% in 2006 and to about 12% in 2012.⁵

Shifting patterns in trade flows can also be seen for Pakistan. An article in *Tribune* in 2012 claimed that the US and the Middle East were decreasing in significance as export markets for Pakistan, while South and East Asia were gaining importance.⁶ While the whole of European Union is still the largest export destination, South Asia – Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal and Sri Lanka – is now the second-largest market for Pakistani goods. In terms of a share of Pakistan's total exports, the EU's has fallen from 28.4% in 2003 to 24.6% in 2012, while South Asia's has increased from 6.3% in 2003 to 16.7% in 2012.

⁴ $F_{ij} = \frac{GM_iM_j}{D_{ij}}$. It says trade flow (F_{ij}) between any two countries 'i' and 'j' is directly related to the GDP of the two countries (given by M_i and M_j) and inversely related to the distance (D_{ij}) between them. G is the equation constant.

⁵ Report of Chamber of Commerce and Industry, 21 July 2012. Available at: http://www.phdcci.in/admin/admin_logged/banner_images/1fa043c48338c381e44d9e71fe02f0b0.pdf

⁶ Farooq Tirmizi, "Shifting patterns: Pakistan's exports tilting to Asia, away from GCC, USA". 24 June 2012. Available at: <http://tribune.com.pk/story/398363/shifting-patterns-pakistans-exports-tilting-to-asia-away-from-gcc-us/>

These trends can be seen in South Asian countries and clearly indicate that trade is shifting away from receding economies to emerging and neighbouring economies.

India-Pakistan Trade

India-Pakistan trade history has been very poor. Political and security issues have affected economic cooperation between the two countries. While India's imports from Pakistan have rarely gone above US\$ 500 million, India's exports to Pakistan average at US\$ 1.6 billion during the period 2005-2014. In a span of a decade, bilateral trade has increased from US\$ 0.87 billion to US\$ 2.7 billion.

Despite being aware of the various possible gains from the untapped trade-potential and the global trends towards greater trade among neighbouring and emerging countries, these two nations hardly feature in each other's total trade. In 2013-14, imports from Pakistan stood at a mere 0.09% of the total imports by India, and its exports to Pakistan were 0.7% of New Delhi's total export profile. This is in contrast to 1948-49 when 56% of Pakistan's exports were sent to India, and for the next several years, India was Pakistan's largest trading partner.⁷

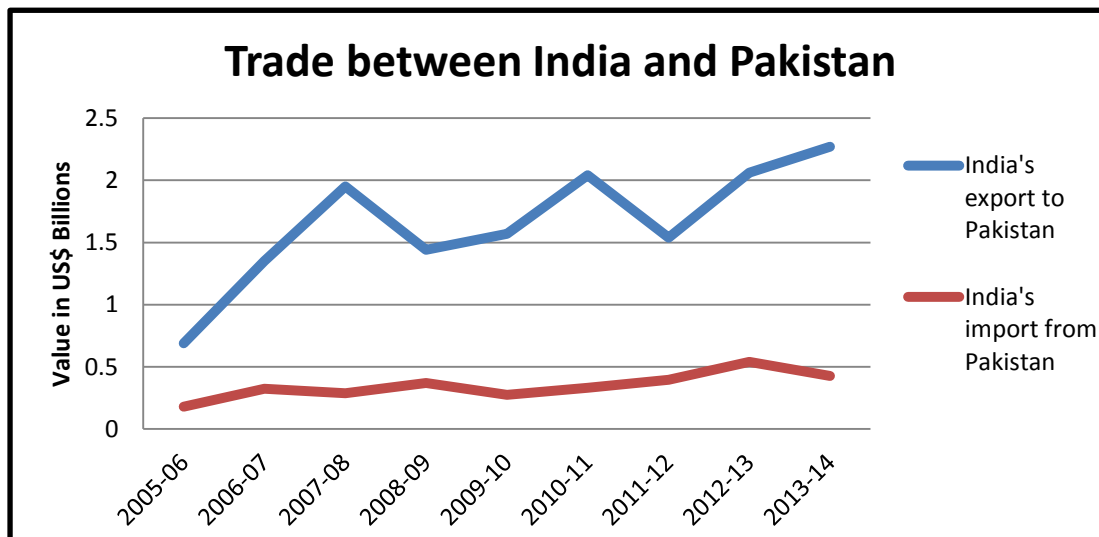


Figure 1

Source: Ministry of commerce, Govt. of India

⁷ Ibid.

Currently, the top five products imported by India from Pakistan are edible fruits & nuts, mineral fuels, raw cotton and denim⁸, organic chemicals and plastics (like unsaturated hydrocarbons, polyvinyl chloride etc.). Indian exports to Pakistan include processed cotton, prepared animal fodder, edible vegetables, plastics and organic chemicals (like polypropylene, xylene, polyethylene etc.).

The following tables show the top five products imported and exported by Pakistan and India all over the world.

Table 2: Top products exported (2012)⁹

	Pakistan		India	
1	Linen/Cotton/Suits	32%	Refined Petroleum	19%
2	Rice	7.9%	Jewellery	6.5%
3	Refined petroleum	3.2%	Packaged medicaments	4%
4	Cement	2.3%	Rice	2.2%
5	Alcohol >80% ABV	1.4%	Cars	1.8%

The percentages denote the shares of various products in the respective country's total exports.

Table 3: Top products imported (2012)

	Pakistan		India	
1	Refined Petroleum	21%	Crude Petroleum	30%
2	Crude Petroleum	11%	Gold	11%
3	Palm oil	4.8%	Coal	3.5%
4	Cars	1.9%	Diamonds	3.3%
5	Coal	1.6%	Palm oil	2.8%

The percentages denote the shares of various products in the respective country's total imports.

Given the shifting trends mentioned above, India and Pakistan have a lot to gain from each other, especially given their cultural similarities. These tables confirm that there is immense trade potential in mineral fuels and vehicular components. Mineral-fuels trade potential alone is estimated at US\$ 10.7 billion of which India's export potential is US\$ 9.4 billion and

⁸ India is the biggest buyer of Pakistani raw cotton.

⁹ OEC Country Database. Available at: <http://atlas.media.mit.edu/profile/country/>

Source: Feenstra, R. C., et al. (2005). World Trade Flows, 1962-2000. NBER working paper 11040 and BACI International Trade Database (1995-2012).

import potential US\$ 1.3 billion.¹⁰ And experts say that a mere increase in the exchange of goods can increase the prospects for a variety of region-wide boons – including increased FDI flows to trans-boundary gas pipeline projects.¹¹

The next two tables give evidence of the trends mentioned earlier in the paper. Pakistan’s top export destinations and import sources now include Asian countries like Afghanistan, China and Malaysia. Similarly, India’s export destinations and import sources include China. With greater cooperation and understanding, India and Pakistan can progress as significant trade partners.

Table 4: Top export destinations for the two countries (2012)¹²

	Pakistan		India	
1	United States	14%	UAE	11.8%
2	China	12%	USA	11.3%
3	Afghanistan	9%	China	5.8%
4	Germany	5.1%	Singapore	5.5%
5	UK	5%	Hong Kong	4.3%

Table 5: Top import sources for the two countries (2012)

	Pakistan		India	
1	China	17%	China	11%
2	UAE	15%	UAE	7.5%
3	Kuwait	8.8%	Saudi Arabia	6.5%
4	Saudi Arabia	8.5%	Switzerland	6.2%
5	Malaysia	4.8%	USA	4.2%

¹⁰ Nisha Taneja, “What’s in it for us? The potential in India-Pakistan trade, Available at: http://southasia.foreignpolicy.com/posts/2013/04/15/whats_in_it_for_us_the_potential_in_india_pakistan_trade_0

¹¹ Michael Kugelman, “The Pakistan-India Trade relationship: Prospects, profits and pitfalls”

¹² Same source as in N 9 above.

Current Issues

Hence, every new government on either side wants to improve relations to facilitate trade between the two countries. India gave the MFN status to Pakistan in 1996. Though Pakistan is yet to give Most Favoured Nation (MFN) status to India because of fear of domestic political ramifications, breakthroughs like Pakistan's transition from a positive to a negative trade goods list in 2012 are significant in liberalising bilateral trade. However, there is still a huge trust deficit between the two countries; they fear that liberalising trade will crush their domestic industries. This can be gauged by the fact that most of the potential bilateral trade items figure in India's sensitive SAFTA list or Pakistan's negative list.

India is protecting its textiles sector, where Pakistan has a comparative advantage. Despite its bigger market size, which would not be affected much by incoming Pakistani goods, India maintains a defensive strategy. Similarly, this bigger market size of India is seen with apprehension by Pakistan; 30% of Pakistan's negative list contains items from automobile sector because it is feared that the relevant Indian products could flood the Pakistani market and crush the local industry. Pakistani farmers feel threatened since the Indian government gives various subsidies to its agricultural sector, rendering the former uncompetitive.

To add to this, land and air routes between the two countries were greatly restricted after the terrorist attack on the Indian Parliament in 2001. Only one land route, through the Attari-Wagah border, is allowed for trade, that too, in respect of only 138 items. Hence, a greater proportion of trade occurs through smuggling or third countries like Dubai estimated at \$250m to \$3billion. One estimate pegs trade via the Mumbai-Dubai-Karachi route at 88% of the total informal trade, and the remainder as cross-border informal trade through the Amritsar-Lahore and Rajasthan-Sind border routes.¹³ This ultimately affects the end users and affects the potential gains from formal trade.

Various recommendations have been proposed by scholars and industry experts to ease trade from both sides.¹⁴ Travel/Visa issues should be made simpler, regulatory framework should be put in place to facilitate investments across the countries etc. The Federation of Indian Export Organizations' (FIEO) President Rafeeq Ahmed has said that governments of both

¹³ Rohit Kumar, "India-Pakistan trade relations: Current and Potential", Jinnah Institute, <http://jinnah-institute.org/india-pakistan-trade-relations-current-and-potential/>

¹⁴ "Paksitan-India trade: What needs to be done? What does it matter?" Wilson Centre, edited by Michael Kugelman, Robert M. Hathaway.

these countries should open more points of trade through the land route. However, both countries expect their counterpart to take the first step in liberalising trade and giving market access.

The Way Forward

Given the pro-business approach both the present governments in these two countries, it is essential to tap the potential now, before the opportunity is lost. Mutual MFN status (or the Non-discriminatory market access status) is essential for starting the process. The two countries should also collectively identify the industries that might be negatively affected by free trade and the best ways to compensate them. If some industries need to be protected, there should be a mutual agreement to that effect. Placing them on negative or sensitive list is not a solution but a dead-end.

Mr Khurram Khan, Commerce Minister of Pakistan, in his recent address to the Hyderabad Chamber of Commerce and Industry (HCCI), said Pakistan would struggle to grow if it were to be confined to its borders. It is inevitable that there will be gains from trade for both sides; economic development will follow from a greater market access. Governments on both sides would benefit from trade tariffs that could possibly be used to improve infrastructure to facilitate greater formal trade, which currently is being lost to illegal trade. They will also experience a stabilisation of prices due to greater supplies and the generation of employment. Besides this, thousands of workers, entrepreneurs, and companies that reap the benefits of trade would pressure politicians to maintain healthy bilateral relations.

Subsequent steps should be aimed at resolving the various logistical issues like the operation of trucks beyond borders, opening of bank branches to ease business. Issues of rigorous quality checks of the imported goods, which sometimes tend to retard trade, can possibly be resolved with mutual collaboration with international organisations like ISO. An ideal future collaboration may also see the giving of mutual transit rights to each other: India could allow Pakistan to access Nepal, Bangladesh, and Bhutan through its territory while receiving rights to access Afghanistan through Pakistan. Economic and political relations are inter-linked and trade could be that road to peace. It has been achieved before with strong political leadership in other nations, and it can happen for India and Pakistan as well.

.....