

## PAKISTAN-INDIA RELATIONS: PEACE THROUGH BILATERAL TRADE

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### Abstract

The idea behind this study is to identify the importance of trade in Pak-India peace process. This study emphasizes that trade is instrumental in achieving and maintaining peace and stability in the Indian subcontinent. Economic interdependence promotes peace and mutual economic benefits preclude war between nations and this concept has been argued in the paper. Furthermore, considering Pakistan-India trade relations; barriers to bilateral trade; current trade volume; measures needed to be adopted for improving bilateral trade and its role in Indo-Pak peace negotiations, territorial and border disputes and peace settlement have been analyzed. It is, therefore, concluded that trade can play a soft and positive role in conflict resolution between the two long standing adversaries.

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**Keywords:** Trade Relations, Peace Process, Economic Factors, Most Favored Nation Status, Bilateral Ties

### Introduction

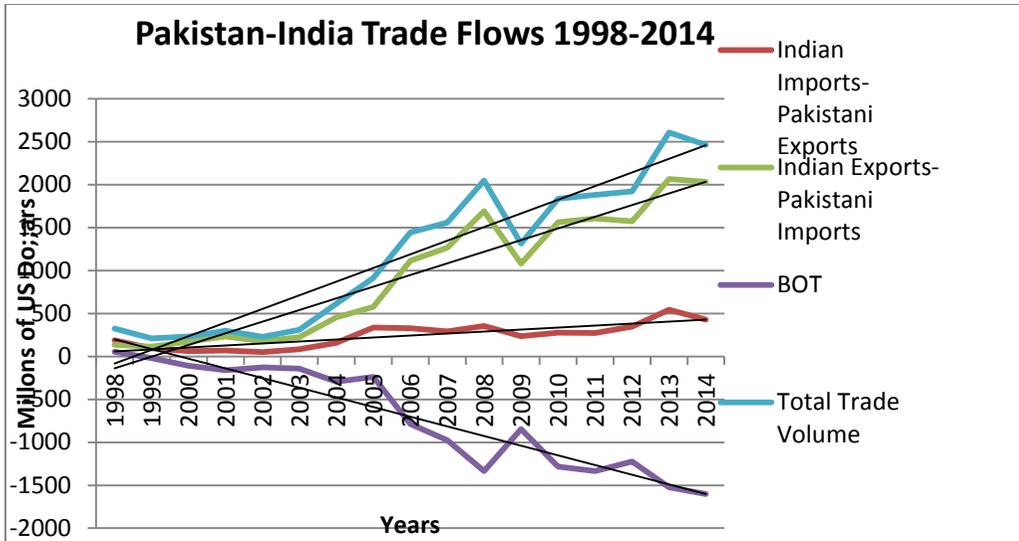
The international environment is changing gradually. The system of the world in new order is moving from unipolar to multi-polar. The interdependence on each-other and cooperation among countries in regions is going to expand. Not only regionalism, but cooperation among super powers is being witnessed these days i.e. Bilateral Investment Treaty (BIT) between United States of America and China. India and China has planned to enhance their economic relations. In this scenario, the proposed study gains it importance to search out new openings between Pakistan and India. In recent years, efforts toward promoting peace in the Sub-continent have revolved around the idea of improving trade relations among the states. Trade relationships between Pakistan and India have been weak. Wars, reforms,

politics, and a general distrust has stalled the growth of developing economic ties, with both sides agreeing to cooperate and collaborate then subsequently falling behind each other's expectations. The countries foreign policies play a vital role in determining the trade relation between Pakistan and India. (Noshina: 2014) The Most Favored Nation (MFN), negative and positive lists, trade relations have been moving towards the right direction although with a lot of inconsistency in the foreign policies. There are ample arguments from hardliners in the both countries and a more exhaustive analysis shows that better terms of trade will benefit both nations. The India-Pakistan trade relations are of paramount importance not only the two countries, but the whole of the South Asian region. There are numerous welfare gains associated with enormous unexploited trade and investment between the two countries. Having a common boundary, trading with each other can be substantially higher in terms of return as the potential is estimated to be over tenfold than that of the level as it exists today. Trade is certainly one of the most important pragmatic measures for fermenting bilateral ties. Even though trade between the two states has enhanced in the last two years or so, it is still far from what is needed. The trade volume of Pakistan and India has averaged less than \$ 1 billion till 2005 and less than 2 billion till 2012 (see Table and Figure 1). Keeping in mind the extent of their international volumes of trade, two details point to the low trade volume in the middle of the two nations - first, neither nation comes in the group of the highest trading associates for each other; and subsequent, share of India in trade of Pakistan averaged under three percent, and share of Pakistanin trade of India averaged below two percent.

Table no. 1 Pakistan-India Trade Flows 1998-2014

Years	Indian Imports-Pakistani Exports	Indian Exports-Pakistani Imports	BOT	VOT
1998	188	135	53	323
1999	96	115	-19	211
2000	62	171	-109	233
2001	70	230	-160	300
2002	50	177	-127	227
2003	84	226	-142	310
2004	158	454	-296	612
2005	337	577	-240	914
2006	327	1115	-788	1442
2007	292	1266	-974	1558
2008	355	1691	-1336	2046
2009	235	1080	-845	1315
2010	275	1560	-1285	1835
2011	273	1607	-1334	1880
2012	348	1573	-1225	1921
2013	542	2065	-1523	2607
2014	428	2031	-1603	2460

Source: IMF, Direction of Trade Statistics (2014)



Source: Authors Estimation and Calculation (2014)

Not merely is the volume of trade level is small, but moreover, a lot of the authorized trading occurs in a particularly narrow band of goods.

### Research Methodology

Qualitative as well as quantitative research methods have been adopted during this research in an attempt to explore the subject in depth. In order to have a fair assessment of the issue, we employ the data from secondary sources such as various books, research articles, journals, and books. This paper is organized in four sections. First section focuses on the brief but comprehensive back ground of research problem. The second section is an attempt to highlight the different stages and benefits of trade. Third section evaluates the status of present situation of peace process along with its mechanism and efforts to enhance trade in the region. Last section of the paper is based on suggestions and concluding remarks. This study is a step towards promoting peace which may lead both the countries in a win-win situation. It is expected that the results of this work would not only facilitate the scholars and experts of political economy but it would be also a massive contribution for the students, and policymakers in the field of development studies.

### Historical Background

Since the inception of India and Pakistan as independent states, a long term confrontation has been witnessed between two nations. For almost six decades the region has witnessed four major armed conflicts (1948, 1965, 1971 and 1999) between both countries. Frequent violation at Line of

Control, allegation of spying and ferocity on embassy staff at both sides are the some of the prominent evidences of antipathy between the two nations. Throughout the history, two nations remained in a continuous conflict and have limited bilateral relations .Despite various efforts the two states failed to resolve their differences amicably. Similar situation is perceptible in the context of trade relations between India and Pakistan. Both the countries have troubled track record due to political and armed conflicts. As a result of partition between India and Pakistan, the unified economy of sub-continent was divided. When British government devalued its currency in 1949, India also followed the same but Pakistan refused to do this practice resultantly India got annoyed and started curbs on trade with Pakistan. By the end of 1949 and at the beginning of 1950s trade relations were suspended but after one year in 1951 India accepted worth of Pakistan's currency and agreement of trade was revived between two nations. (Noshin 2014).

Both countries went to war over the Kashmir issue on 6 September 1965. This 17 day war ended after the UNSC issued a resolution calling both parties for a cease-fire. India accepted the resolution on September 21, 1965 .The next day Pakistan followed suited. On January 10, 1966, the two parties, signed the Tashkent Agreement, brokered by the Soviet Union. The declaration stressed that "both sides will exert all efforts to create good neighbourly relations between Pakistan and India in accordance with the United Nations Charter. They reaffirmed their obligations under the Charter not to have recourse to force and to settle their disputes through peaceful means.( Maria, 2006:78).Due to the war of 1965, trade relations were again suspended between two nations but later in 1966-67 the leaders of both countries by signing the Tashkent pact reopened the avenues of economic relation; though the scope of this bilateral tie was limited at that moment.

The Third Indo-Pak war transformed the regional balance of power and impacted upon the two countries, approaches toward their bilateral relation. Simla agreement was signed by India and Pakistan on July 2, 1972, to settle some matters related to the 1971 war. This agreement provided the two countries a set of guidelines for their future bilateral relations. Three years later, in January 1975 a full-fledged trade agreement was signed by both nations and railway corridors were also opened. Relations between India and Pakistan showed strong sign of improvement once in February 1999, when Atal Behari Vajpayee ,Prime Minister of India, visited Pakistan in order to opening of the Lahore-Delhi bus service. This visit was a response of an invitation by Nawaz Sharif, the Prime Minister of Pakistan. At this meeting which appeared like a breakthrough, the two Prime Ministers discussed all aspect of bilateral, regional as well as international issues. The leader of both countries signed the Lahore Declaration which expressed their shared vision of, prosperity peace and progress for their people. The two

sides also agreed to make more serious efforts to solve all bilateral questions including trade and Kashmir ,through dialogue and agree not to interfere in each other's internal matters. However, Soon after the outbreak of fighting in Kargil in 1999, interrupted the harmony of relations and trade relations were again suspended. (Effendi Maria 2006:78)

The new international environment that emerged after 9/11 further complicated both India and Pakistan's relations. The changing dispositions were found in relations of both countries in first decade of twenty first century but international trade remained insignificant. The situation in the subcontinent was changed in 2003, when Mr. Vajpayee announced that India would upgrade its diplomatic representation in Islamabad to the level of high Commissioner and restore air links with Pakistan on a reciprocal basis. Thus Indo -Pakistan relations began to improve and there were exchanges of official visits and other confidence-building measures. In late November, India accepted Pakistan's offer of a cease-fire along their shared border in Kashmir, thus ending the constant exchange of artillery fire there for the first time in 14 years. During year 2004-08 trade dialogue was again taken place and trade was reinstated. There was intense behind the scenes diplomacy in which many important powers participated and countries friendly pressed both side to take major steps to defuse the tense situation. Thus Mr. Vajpayee visited Islamabad in the first week of January 2004 to participate in the 12<sup>th</sup> SAARC conference. In a joint statement, the two countries agreed to begin a composite dialogue process and agreed to taken steps in order to improve political and economic relations. Thus there was a major breakthrough in Pakistan-India relations which speeded up the normalization process. After this very important summit, the two countries began moving ahead with peace initiatives through different confidence building measures (CBM) including intra-Kashmir bus and truck services, the opening of crossing points on the Line of Control (LOC), eased visa restrictions, economic and commercial cooperation; and promotion of friendly exchanges. These CBMs transformed the political atmosphere in the region offering a unique opportunity to both countries to resolve their dispute. (Farmer 2014 ).To enhance the cooperation in trade , India and Pakistan signed trade agreement South Asian free trade area (SAFTA) to replace SAARC preferential trading arrangement (SAPTA) in January 2004 at 12<sup>th</sup> summit (Islamabad) The SAFTA was enter in to force in 2006. The treaty provided the episodic elimination of tariffs: these were to be reduced to 30% in least developed member's countries and to 20% in the others in the initial two-year period, and subsequently to 0-5% in the next five years. The Agreement established a mechanism for administering SAFTA and for settling disputes at ministerial level. (Article 3 of SAFTA).

Four rounds of trade talks were held between the two countries, from 2004 to 2007, which aimed to strengthen economic ties. In 2008, both sides agreed an agreement should be finalized for liberalizing their visa regime that would facilitate people-to-people contacts. There were some improvements in the atmospherics between the two countries as a result of composite dialogue. Bilateral trade has improved. Travel by bus and train between the two countries have become more organized and frequent. Bilateral relations of both countries appeared to be on the course towards normalization. However, the Mumbai Attacks were a significant derailment of the growing understanding between the two nations.(Daily Dawn) Despite Pakistan's protestation that those involved in the Mumbai attacks were non-state actors and that the government of Pakistan was blameless in this regard, the Mumbai attacks caused a severe setback to Indo-Pak relations. The confidence building measures and other initiatives for bring a permanent peace to the subcontinent appeared to have been in vain. The Indian government reacted severely to the incident. It stopped all trade ties with Islamabad, the secretary level talks on important matters like foreign policy, commerce, certain clauses in Simla agreement, and disputes in the water sharing treaty were put off indefinitely. These relations were temporarily suspended in 2008 after Mumbai attacks but this time some trade continued despite the conflict. Indo-Pakistan relations, in post Mumbai attacks, came to the lowest point but after the lapse of three years diplomatic ties in early 2011 were reestablished. (Taneja N & Pohit S 2014). Improved trade relations were witnessed in March 2011 after revival of Pakistan India dialogue. One of the reasons could be globalization which promoted regional co-operation on economic grounds in the region. Bilateral trade was initiated by business communities at both sides in spite of the existing conflicts. In 2011, finally after a 5<sup>th</sup> round of talks, decisions were taken to phase out the negative back into the favour of a positive list. The Chambers of Commerce from both countries were linked together and the Commerce Minister of Pakistan visited his Indian counterpart after a gap of 35 years, resulting in a return visit by the Indian Commerce Minister in February of 2012. By realizing the synergy of bilateral relations both countries are now at the move to improve economic relations with each other. India and Pakistan mutually decided to cooperate in customs cooperation and joint recognition of standards in 2012.

### **Current Bilateral Formal Trade Volume**

Presently, trade between Pakistan and India is taking place through two channels. (State Bank of Pakistan, 2006).The formal trade, that takes place through official means; informal or illegal trade through smuggling via porous Indo-Pak land borders and thirdly through third countries. The first channel which is the formal one - is quite meager because the current volume

is just \$ 2.7 billion. However, the size of informal trade and trade via third countries is around \$ 8-10 billion according to the statistics given by different reports. The volume of informal and third country trade indicates the tremendous potential for bilateral trade between the two countries. If Pakistan and India normalize their economic relations it will enhance the formal trade and as a result both the countries will earn significant revenue, which is lost due to informal trade. Formal trade will also ensure cheaper raw materials, lower transportation costs and wider markets for the businessmen. These measures will benefit the consumers of both the countries. Increase in formal trade will help economies of both the countries in terms of revenue collection, exports of goods and lower costs. The higher volume of formal trade will increase economic dependence of Pakistan and India on each other. Resultantly, both governments will be compelled to normalize their political relations and resolve their border disputes in an amicable manner. Increase in bilateral trade can help in resolving the political issues and reducing poverty. It is needed to be realized that bilateral trade will act as a forced multiplier so both the governments should concentrate on making efforts for promoting two-way trade. Neighboring countries may have differences over one issue or another but better economic cooperation and trade activities can transform their aspect of political relations. Bilateral trade can be instrumental in removing misperceptions between the people of Pakistan and India as well. They need to open more trade routes because the current trade volume is much below the desired one. Trade is taking place via third channel and therefore both the countries need to facilitate direct trade in order to achieve win-win results. Direct trade will help in enhancing people-to-people contacts.

### **Trade Promotes Peace**

Trade promotes peace, reduces conflict and accelerates the economic activities. The low volume of trade between Pakistan and India is due their territorial and border disputes. If bilateral trade is increased the mutual economic benefits will also increase and thus it would discourage cross border terrorism and violence. Economic interdependence promotes peace and tranquility because conflict is inconsistent with mutually beneficial economic ties. Improved trade relations and rise in import and export between Pakistan and India will reduce the probability of cross border skirmishes. The high export and import flows in economic sectors influence the decision to initiate a military conflict. The establishments or competent authorities of both, in Islamabad and New Delhi will have to consider about the opportunity costs of conflict which might lead to losses in trade. The political leaders and policymakers of both countries need to rethink the logic of how trade affects conflict, and has various political implications. In fact,

trade facilitates bargaining over some political and border issues and can be used as a tool that can influence decisions of the leaders on the territorial disputes such as Kashmir, Sir Creek and can create a cordial atmosphere needed to take new initiatives. Countries that have permanent trade relations with each other don't opt for rivalry and if a political conflict arises between them, they solve it in an amicable manner. But this fact has not been realized by the governments and political leaders of Pakistan and India.

Closer economic cooperation between Pakistan and India is essential for increasing the trade volume. It is a general view that better economic relations between the two countries are marred by the territorial disputes and cross-border terrorism and therefore trade cannot play a role in improving bilateral relations. This argument can be proved wrong. In recent history the political conflicts and worst relations among states have been normalized through greater economic cooperation and trade. There are several examples worldwide –The European Union and ASEAN ect -where trade and economic cooperation has played a major role in conflict resolution between neighbouring countries. the US Congress authorized designation of qualifying industrial zones (QIZs) between Israel and Jordan in 1999 and Israel and Egypt in 2004.<sup>4</sup> The QIZs allow Jordan and Egypt to export to the US duty-free if the products contain a minimum level of inputs from Israel.<sup>5</sup> This trade initiative was aimed at supporting peace and stability in the region by encouraging economic cooperation. It has worked well. Since both India and Pakistan are not on good terms it would be sensible to include QIZ-type of arrangement in some of their agreements particularly with the EU, the US and China and even within SAFTA. Such arrangements would help boost both Indian and Pakistani economies as well as the process of peace negotiations. The establishment of the European Union (EU) effectively united the Continent that for long was divided and warring. The EU has led to higher levels of economic well-being resulting from enhanced economic cooperation amongst the member states. History provides ample examples that no neighboring countries have ever survived and progressed on prolonged belligerent relations. Commercial relations can serve as a means to improve of political relations and maintenance of peace and stability. Both India and Pakistan are facing hurdles in their way towards peace building. The trade and economic cooperation between them can reduce tensions and distrust and can ultimately bring peace and tranquility to the whole region.

### **Barriers to Bilateral Trade**

Politically India and Pakistan are perceived arch rival in the region. Since independence, bilateral economic relation has been adversely effected by political factors. With a vision to enhance peace and prosperity to flourish in the region, the two countries are now progressing toward a close economic

relation realizing the synergy of bilateral potential. The issue of Pakistan granting India Most Favourite Nation' status has long been a focus of trade talks between India and Pakistan and. (Ankit Panda 2014) Pakistan and India are the members of World Trade organization (WTO). Besides this both countries were among the signatories to the General Agreement on Tariffs and Trade (GATT), the forerunner of the WTO. (Imam A H. 2011).The border disputes and political conflicts prevented both countries from fulfilling their GATT obligations. India finally granted Pakistan the MFN status in 1996 under the WTO agreement, but Pakistan has failed in reciprocating it so far but nevertheless the 'positive list' items have been increased in 2006 and then more recently in 2013. It presently includes almost 2,000 items. (Taneja N. 2007)

It is reported that Pak-India informal trade (which occur through a third country) accounts for more than formal trade (which is around US\$4 billion).<sup>23</sup> Despite Pakistan's recent rejection of MFN status to India, the latter can unilaterally reduce all kinds of non-tariff barriers that will be capable in creating confidence among Pakistani traders. Better trade relations among nations help them in improving political relationship. A case in point is the strong economic relations between China and Japan, which assist them in stabilizing fluctuating political relations. (Mohanty B & Hazary S C 1997). Giving the MFN status to India may lead to greater economic cooperation between the two states which can help them in the long run, particularly, in building the trust deficit needed in resolving the territorial disputes. In this continuum, Pakistani government announced to open up trade in 6800 areas which were previously banned. In the same year, visa policies were also relaxed by both governments. A mutual agreement was made to flexible the business travel in order to improve economic partnership (Siddique, 2013). Islamabad should not be worried about granting the most favorite nation (MFN) status to India as 1,936 goods are already being imported from the neighboring country (Qamar A.2005).Furthermore Pakistan can forge joint ventures with Indian companies in Information Technology sector. Enhanced trade with India will not only lessen the pressure of escalating inflation in Pakistan, but the political conflicts as well. This would help both the countries not only in strengthening their economies, but, more importantly, an improved trade relationship could finally bring a lasting peace and prosperity in the region. Presently, Pakistan is importing around \$10 billion goods from India out of which \$4 billion products are imported via third countries. (Achrya L & Marwaha A 2012).If the MFN status is granted to India, more direct trade links will be established so more revenue can be generated and this economic cooperation between the two countries will lead to promotion of regional trade in the South Asia. In fact, the future of the whole region depends on the relationship between two major players.

Escalating tensions between India and Pakistan have always threatened peace in the sub-continent; hence both countries need to improve their economic relations so that regional peace and security can be maintained. In addition to political negotiations, economic diplomacy is also required to shift the priorities and achieve the objectives which are necessary for regional stability. Major breakthrough both on political and economic fronts need to be obtained. Undoubtedly, the economic cooperation is a must to make south Asia a tension-free zone. Economic activities can contribute to a large extent towards regional integration. **The relationship between Pakistan and India has remained turbulent, but critical to peace in the region.** Territorial and border disputes such as Kashmir, Siachin, Sir Creek, water dispute, terrorism etc need to be discussed and strong trade ties can pave a way for the peaceful resolution of all these disputes. (Hindustan times 2014) According to the Indian Minister Commerce and Industry ,Sitharaman, "Progress in trade normalization would depend on the decision taken by Pakistan with regard to granting MFN status to India," if MFN status is granted to India by Pakistan, it would facilitate direct bilateral trade and lead to "economic gains for both countries".(The Daily Nation December 2014)

There is no country in the world which is self-sufficient and produces all the commodities it needs. The developed countries export consumer and industrial goods to the developing world and import raw materials from them. Textile industry can be termed as the backbone of Pakistan's economy. It is one of the biggest sources of foreign exchange earnings. The Textile sector mainly depends on the supply of raw material from agriculture sector and therefore, whatever happens to cotton crop is likely to affect the performance of the textile sector. The size of the cotton crop has always remained on the higher scale in Pakistan. The textile industry provides employment to 38 per cent of the labour force of the country. India may become the biggest market for Pakistani textile industry. Furthermore, Pakistan is also a leading producer and exporter of leather products. Again India is not in the list of the leading importing countries of Pakistani leather products due to various trade barriers. Pakistan has the highest per capita consumption of tea in the world and it imports tea mainly from Kenya. Pakistan imports iron, wheat and sugar from Australia, United States and Indonesia. Similarly, Pakistan imports vehicles and spare parts, pharmaceutical products from countries other than India.<sup>12</sup> It exports raw cotton, Carpets and rugs, Tents, sports goods, readymade garments to other countries. (Import and Export of Pakistan 2013)

Pathetically India is not on the top of the trade partner list, either as an exporter/ importer due to various constraints. For instance, Pakistan has not yet reciprocated the MFN status to India although the latter has expanded

the positive list (of goods) that India may export to Pakistan. On the other hand, India's tariff rates remain high on textiles and leather goods. Moreover, nontariff barriers are substantial. Poor transportation, visas constraints and cumbersome payments and customs procedures limit the scope for trade between the two countries. It has been argued that electoral politics in both countries —have also remained major obstacles in the way of greater economic cooperation. (Khan,S,R 2008) But the recent thaw in bilateral relations suggests that the two governments understand that they can no longer forgo stronger economic ties. The border disputes between Pakistan and India can only be resolved by developing trust and connections between them. Trade can be instrumental in this regard. Studies suggest if restrictions are minimized and trade between India and Pakistan is allowed to flourish, a pathway towards peace would automatically develop. Not only the workers, businessmen, investors and companies, the direct beneficiaries of trade, would pressurize politicians to maintain cordial and bilateral relations but the mutual economic benefits would also compel both the states to maintain cross border peace. Therefore, the two governments should make trade their top priority. It is in the mutual interest of Pakistan and India to strive for an enduring bilateral relationship. The improvement in trade ties between the two countries will not only result in economic growth but will also be helpful in improving regional stability and peace. Despite political conflicts, trade expansion between India-China, China-Taiwan, US-China, and US-Russia illustrate that economic cooperation is an effective instrument in improving interstate relations. Pakistan and India can establish a trade relationship that can pave a way for resolving political and border disputes, including Kashmir, between the two long time nuclear-armed rivals.

## **Conclusion**

Trade between nations directly contributes to peace and tranquility. Trade creates an economic interest between nations and develops contacts between people which help them in mutual understanding. Countries are less likely to involve in a war if they have mutual economic benefits. Strong economic ties between Pakistan and India are essential for the peaceful resolution of the territorial disputes. It is true that conflicts have hampered Pak-India bilateral trade but it is also equally true that more trade will be a significant confidence building measure which will facilitate peace and reduce tension. Pak-India mutual trade can be promoted and enhanced by taking some major steps including **a)** elimination of non-tariff barriers to trade; **b)** facilitation of the cross-border movement of goods; **c)** promotion of conditions of fair competition and equitable benefits; **d)** creation of effective mechanism for the implementation and application of the agreement; **e)** simplification of customs clearance procedure and banking procedures for

import financing. Moreover, development of communication systems and transport infrastructure; simplification of procedures for business visas and establishment of a framework will also facilitate the economic cooperation. Apart from that There is a dire need of drawing a rigorous framework for trade that should be formulated independent of any political pressure. Both the countries need to discuss a roadmap for removing bottlenecks in liberalization of bilateral trade and to remove all hurdles in the trade relations. Indian government needs to address concerns of business community in Pakistan regarding non-tariff barriers and other issues which impact export of goods. Hence, improved trade relations between Pakistan and India are inevitable for stability and thus security in the Sub-continent.

Notwithstanding, these positive changes along with, several hurdles continue to exist due to political differences between the two countries. Some policy makers in Pakistan insist that unless the territorial disputes between two countries are resolved, trade and economic cooperation will remain low. However, this is not the case. A relationship which is based on trust and willingness and is backed by economic and commercial links can pave a way forward in the name of peace and prosperity. Enhancing mutual trade will not only bring benefits to the whole region but will also prove a key determinant for lasting relations between the two neighbours. It is, therefore, concluded that trade can play a soft and positive role in conflict resolution between the two long standing adversaries.

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