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On Trade with India

In both India and Pakistan, there are voices that advocate for better trading ties as a "win-win situation," arguing that economic rapprochement is either (1) a circuitous route to normalizing relations which bypasses political hurdles, or (2) a simpler and more efficient path to economic growth based on trade complementarity. Such people cite China-Taiwan relations or other cases as examples of how this can be shown to work. But looking solely at the economic merits of trade rapprochement, is it really a "win-win situation" as the proponents claim? We tested whether normalizing trade ties with India had economic merits, and did so without delving into sociopolitical considerations. Our findings were that the economic merits of trade with India are largely exaggerated, that Pakistan would be a net loser from the bargain as it stands today (with our current level of trade complementarity and complexity), and that the benefits of bilateral exchange are likely to accrue largely to India.

The analysis drew upon several aspects of the economic impact from Indo-Pak trade practices and outcomes over the period 2000-2014, including trade complementarity, trade mix and growth, non-tariff barriers to trade, and consumer surpluses. First, to build a large trading relationship with an erstwhile hostile neighbor is a double-edged sword. On the one hand, economics might appear to be a bridge that would dissuade countries from pursuing open conflict. On the other hand, it offers a non-kinetic lever with which to punish a country before resorting to kinetic means. When Modi sought to up the ante against Pakistan in 2019, his own people laughed at him on social media when he claimed that he would "punish" Pakistan economically. Punish with what? Indo-Pak trade was miniscule in absolute terms and was a small fraction of the mix in both countries' external trade (3% of Pakistan's mix, 0.4% of India's). One cannot use trade sanctions as a weapon if there is hardly any trade, they joked.

Second, both countries sold very rudimentary and low-value items that did not forcibly require bilateral trade to meet local demand, In 2015, exports from the Pakistan-side included the following: edible nuts & fruits (22% of the total) were at $68 million, while basic materials were nearly another one-fifth (18%). This also applied to India's exports, where cotton comprised one-fifth of exports (20%) at $340 million, while organic chemicals and plastics together made up nearly another one-fifth at $317 million. Other categories from the India-side included vegetables, tanning materials, oil seeds, and staple fibres. Third, the rate of trade expansion was different between both and it was disadvantageous to Pakistan: its exports to India grew nearly fourfold over the period 2003-15 (from $84 million to $312 million), but India's exports were higher to begin with and grew eightfold (from $226 million to $1.6 *billion*). They would very likely repeat this pattern in a future rapprochement: starting out large and then growing even faster.

Fourth, it should be categorically noted that, in the 2000-2014 period, India was not a "straight" player in terms of trade. It employed sophisticated tariff and non-tariff strategies to make Pakistani goods more expensive or simply too difficult to enter the Indian market, and dissuaded their traders from buying Pakistani goods when possible. Non-tariff barriers are an economic tool that violate the spirit of exchange and commerce, and in any new thawing of relations, it is entirely likely that India will repeat those strategies. Fifth, and of no less significance, was Pakistan's low trade complementarity with India, where "trade complementarity" is defined as the portion of India's import requirements that coincide with Pakistan's export profile, and vice-versa. India has had a high score on the index relative to Pakistan's import requirements (50-60%) in the period 2013-15, suggesting that India was well positioned to export much more to Pakistan over time. Meanwhile, Pakistan's complementarity score was very low relative to India's requirements (16-18%). This speaks to an inherent disadvantage that Pakistani economic sectors (industry, agriculture) face in growing their export revenues. In future trade engagements, our low trade complementarity to India's import requirements would continue to pose a problem, and in fact worsen since the structure of their expanding economy means that they require increasingly sophisticated categories of products – ones Pakistan is even less likely to meet.

There is a claim that enhancing trade would ultimately lead to better complementarity and to improved competitiveness, and that the causation would be to first open up to trade and then see greater dynamism or complementarization. But this did not happen in the period 2000-14. Also, it would assume several things that do not exist in the Indo-Pak context: (1) the absence of non-trade barriers, through which Indians have quietly but effectively dissuaded their businessmen from purchasing Pakistani goods; (2) a more equitable distribution of capital among both countries, so that both would be investing in one another rather than one dumping its surpluses over the border, (3) a nobler longer-term goal such as regional stability or integration (as opposed to regional hegemony) that both countries could work towards, and (4) freedoms that are complementary to trade in goods, including significant freedom of movement, of temporary residence, and of trade in services (not just goods). Each of these four factors existed in the China-Taiwan economic relationship so that it could be made to work on normalized terms. But India is not an honest broker on any of these accounts.

In terms of Pakistan's economic challenges of a current account deficit and high inflation, trading with India would reduce one but worsen the other. Trading in foodstuffs and other commodities (such as tomatoes) would lower their price here, but reducing inflation would come at the expense of foreign exchange spent abroad. This would also have local employment consequences; and so what the consumer would gain, the employee might lose. In essence, we would be converting an inflation problem into a current account problem. But there are much better ways to deal with local inflation, including tackling the sources of hoarding and price manipulation domestically.

Our analysis did not even touch upon the ideological, security and political costs to both countries. After all, India continues to binge-spend on military procurement, not least for its air force, and Pakistan must therefore invest in its security, even if economic ties were “normalized”. It would thus not only face deficits but also continue to face pressure to keep its defence needs in context. Beyond this, many if not most Hindus today in India hold decisively biased views against Pakistan at various intensities, as expressed in their voting behavior and the electoral success of the BJP, and would therefore penalize a hardline Indian government for taking any soft approach. Conversely, would it be worth sidestepping Pakistan’s principled stance on Kashmir or other important issues merely to sell low-grade items such as fruits and nuts? Hardly so, and yet those larger belief-systems notwithstanding, simply the economic factors offer a cautionary point on why not to jump into a large trading relationship, while many other major questions continue to simmer on the table.

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