

PROMOTING PEACE THROUGH CLOSER ECONOMIC COOPERATION BETWEEN PAKISTAN AND INDIA

Lecture at SDPI on 2nd December 2011 at Islamabad, Pakistan

Pradeep S Mehta¹

Outline

- 1. Impact on Consumer**
 - 2. During Crises**
 - 3. India will dominate the economy of Pakistan if trade is liberated**
 - 4. The MFN Conundrum**
 - 5. Standards and non-tariff barriers**
 - 6. Mutual trade is beneficial**
 - 7. Cross border infra projects**
 - 8. The 'K' factor and moving on**
 - 9. Will there be a peace dividend if the cooperation is concretised?**
-
1. A foundry equipment manufacturer in India procured an order of Indian Rs 7crores for supplies to a new foundry in Pakistan in 2004. The equipment was routed through Dubai with all signs of India removed from the machinery. The Pakistani importer had to pay at least 17 percent more than what he would have paid if he could have imported the equipment directly from India.
 2. In any case the cost of similar equipment from other countries would have been higher by at least 35 percent, so the Pakistani businessman soundly bought the

¹ Secretary General, CUTS International, Jaipur, India who can be reached at psm@cuts.org

equipment from India. When he will need to buy spare parts, he would follow the same circuitous route. Similar experiences obtain in many such situations, where goods worth hundred of crores from India and Pakistan are bought through either a circuitous route or clandestine channels.

3. Though official bilateral trade figures are pegged at slightly less than \$400mn, illegal trade is \$1.5-2bn. Informal trade, through third country like the foundry equipment purchase, is another \$1bn. Some talk of a range of \$2-8bn! Official trade figures apart, informal and illegal trade are mere guesstimates. Nevertheless, they indicate the huge potential for trade.

4. A World Bank study based on field research in border regions, Dubai and major urban markets has estimated informal trade between India and Pakistan at \$545 million in 2005. The Indian Council for Research on International Economic Relations (Icrier) in its 2007 survey of Indian firms estimated a vast untapped trade and investment potential between the two countries in goods and services. The study showed that the total trade potential between the two countries is \$11.6 billion, of which Pakistan's export potential is \$2.1 billion and \$9.5 billion for India. Business chambers of India and Pakistan have also identified several items with export potential, including services and tourism.

Impact on Consumers

5. In all this number crunching, the plight of the consumer and the producer, be it in India or Pakistan is rather unenviable. The Pakistani consumer pays higher costs virtually for every commodity coming from India, primarily because of a round-about the consignment takes to reach from India to Pakistan. Also, something available in

the neighbourhood, is not permitted becomes more costly at the point-of-purchase, being sourced from a costlier supplier. India should consider a preferential tariff and reduced non-tariff barriers formula for Pakistan.

6. It is, therefore, pertinent that bilateral relations be strengthened to reach the true potential. An ongoing study by CUTS in partnership with SDPI and others in Nepal, Sri Lanka and Bangladesh entitled Cost of Economic Non-Cooperation to Consumers in South Asia supported by the Asia Foundation took into account the impact of tariff liberalisation under SAFTA on consumption expenditure of five of the largest countries of South Asia and found that trade between India and Pakistan has the highest growth prospect. While a large share of gains to Indian consumers will be through Pakistani exports in plastic-based articles, minerals and mineral fuels, Indian exports in pharmaceutical ingredients and electrical equipment will significantly reduce the burden of Pakistani consumers.

7. The study also shows about 91.24 per cent of the total consumer welfare due to India accrue by way of imports of rice, plastic and polyethylene based articles, household articles made of polymers, cotton yarn and woven fabrics from Pakistan. India's total current import expenditure on these items is about US\$939.54mn, out of which not less than US\$545mn can be saved if such imports from outside the SAFTA region is replaced by imports from Pakistan.

This implies that India and Pakistan can together save a minimum of 55 per cent of their import bills in about 200 product categories, reducing the consumption expenditure by buyers of both the countries by more than US\$800mn per year. On the other hand, the main product categories which exhibit maximum consumer welfare

gains for Pakistan from imports from India are pharmaceuticals and ingredients for medicines, various electrical and electronic products including telephonic or telegraphic switching apparatus, and automotive spare parts.

8. The study also found that annual welfare gains to Indian consumers by importing certain products from Pakistan would be around US\$4bn and similarly it would benefit Pakistani consumers by US\$280mn by importing certain products from India. Considering the population of Pakistan at 178mn, the gains would translate to US\$15.73 per person, and 1.2bn people in India meaning a gain of US\$3.30 per person, annually. The big figures apart, the gain to Pakistan would be nearly five times that of India.

The gains can come from areas such as farm goods, automobile spare parts, and pharmaceuticals. For instance, India enjoys such advantages in cotton, textiles, coffee, tea, spices, man-made fibres and vegetables products. This will also help in increasing the level of intra-industry trade between the two countries which stands at a low level despite geographical contiguity and cultural affinity.

9. At present, Pakistan, which has one of highest per capita consumption of tea, imports 150mn kgs mainly from Kenya, even though Pakistanis prefer Indian tea. India also does not buy all its goods from Pakistan directly. If it did, as is experienced today, the Chana (chickpea) in our dal in Delhi would be much cheaper being sourced through Wagah than from Maharashtra!! Zinetac, a patent medicine for acidity, sells in India at Rs 7.20 for 10 tablets; it retails in Pakistan for between Rs 80 and Rs 150.

10. For decades, Pakistan imports iron ore, rice and sugar from Australia, Indonesia and Brazil respectively. If we take just another example of Suzuki motor cars, Pakistanis pay more than twice as much than what an Indian would do in India. The spare parts of the car are believed to cost nearly seven times as high. Instead, it could have been imported these from India, and enjoyed lower transport costs. Do we see an opportunity here?

During Crises

11. Significantly, in times of crisis we knock on our neighbour's door. In 1990, India helped Pakistan tide over a potato and onion crisis, and during a sugar shortage in 1997, it imported 50,000 tons of Indian sugar. Recently, too, Pakistan sourced meat, tomatoes, onions, garlic and potatoes from India, duty free, to rein in prices and meet domestic demand.
12. Similarly, in 2003 India sourced enormous consignments of grains from Pakistan due to an emergency. Where else could both have acquired food supplies on an emergency basis but from its neighbour? It is expected that if importers decide to pass through the price differentials domestic prices would drop by 15-20%.
13. On the other hand, Pakistani industries and engineering sector can benefit from the import of machinery and basic and intermediary raw materials to reduce the costs of capital goods and machinery as well as the finished goods. Pakistani textile industry can be the single biggest beneficiary because Pakistan leads India in coarse counts 20s and below and India leads Pakistan in fine counts 40s and above.

14. In addition, India needs to source woven fabric from Pakistan; one of the heaviest and more recent investments made by Pakistan textiles sector is in the woven sector, what could be a better market? Allowing the import of capital goods and machinery from each other will offer substantial savings in freight costs and time due to the geographical proximity.

India will dominate the economy of Pakistan if trade is liberated

15. Admittedly, Indo-Pakistan trade is competitive rather than complimentary, and according to some trade pundits, there is little scope for expansion. However, a large informal, illegal, border, call it what-you-like trade indicates the contrary.

India should not be looked as a competitor alone, for sure India will win the numbers game in the short run due to its huge market size, however, Indian market should be eyed as the hub of investments and transfer of technology not alone for Pakistan but for the whole region. On the contrary, neighbouring countries can gain due to the expanding economy of India.

16. There is concern that if Pakistan liberalises trade relations with India, the latter will dominate Pakistan's economy. Undoubtedly India will have a trade surplus against Pakistan as it has with other neighbours, Bangladesh, Nepal and Sri Lanka. Yet no one complains. To the contrary, the Free Trade Agreement between Sri Lanka and India has led the two to initiate talks on further custom union integration. Simple economic rationale indicates that India enjoys these surpluses because of the size of its economy and the comparative advantages it enjoys. But this does not translate into a domination of Pakistan's economy by India.

17. If strong economies always dominated bilateral trade then China and the US would dominate all economies with which they have a trade surplus.

18. On the contrary, USA runs a deficit with most trading partners, which do not dominate the American economy. China has a trade surplus against US, which exceeded \$68 billion in 2000. China had a trade surplus of \$ 0.8 billion in 2003 against Pakistan. This doesn't indicate economic subjugation. On the contrary it indicates vibrancy and a leashed domestic demand waiting to be harnessed and catered to. Bilateral trade will help both countries.

19. The Southern African Development Community originated in the 1980s as a coalition opposed to apartheid in South Africa and, more recently, turned to creating a free trade area. Some observers note that African Customs unions and free trade areas are as active in areas such as conflict resolution as in trade liberalisation. Finally, many see relaxed tensions between India and Pakistan as the real payoff of SAFTA (World Bank, Global Economic Prospects, 2005).

20. Regional trading blocs may be an instrument for peace and prosperity. As Keynes observed, "A Free Trade Union, comprising the whole of Central, Eastern and South-Eastern Europe, Siberia, Turkey, and (I should hope) the United Kingdom, Egypt and India, might do as much for the peace and prosperity of the world as the League of Nations itself."

21. Keynes said that trade and commerce have been the most effective way of establishing peace between rival nations. The formation of the European Union most 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 evidence that no neighbouring countries have ever survived and progressed on prolonged belligerent relations. “History repeats itself” is the saying going around time and again. The famous economist, Mr Wilfred Pareto (1889) wrote, “customs unions and other systems of closer commercial relations (could serve) as means to the improvement of political relations and the maintenance of peace”.

Until recently, it was not known that to promote peace in West Asia, the US had adopted a similar scheme. In 1996, US Congress authorised designation of qualifying industrial zones (QIZs) between Israel and Jordan (1999) and Israel and Egypt (2004). The QIZs allow Jordan and Egypt to export to the US duty-free if the products contain a minimum level of inputs from Israel. The purpose of this trade initiative was to support the prosperity and stability in the region by encouraging economic cooperation. It has worked well.

The MFN Conundrum

22. Indo-Pak trade could have grown by even higher rates had Pakistan reciprocated in according the Most Favoured Nation (MFN) status to India under its WTO obligations. Pakistan has expanded its positive list of imports from India from 774 products to 1074 products. These products include machinery/equipment, raw materials, chemicals and accessories of a number of manufactured items that are in great demand in Pakistan. Presently, the main commodities of export to Pakistan are

dyes, sugar, plastic and petroleum products and cotton while the main items of import are petroleum and crude products, fruit, cotton yarn and fabrics and organic chemicals.

23. There would be losers if trade is liberalized in both countries, hence there will be some resistance. But, liberalization globally too has the same reactions and countries do adopt protectionist policies to assist the affected domestic sectors. Furthermore, countries look at the holistic picture and see what would be the overall gains and look for win-win solutions.

24. It is expected that the resumption of the composite dialogue process between India and Pakistan will give a fillip to bilateral trade, besides facilitating early execution of various gas pipeline projects such as Iran-Pakistan-India (IPI) and the Turkmenistan-Afghanistan-Pakistan-India (Tapi) projects involving the two neighbours. It is hoped that bilateral trade between the two countries, which stood at \$2bn in 2007-08, rising from a low of just \$235.74mn in 2001-02, would touch \$5bn by 2010. During 2002-03 and 2007-08, India's exports to Pakistan and its imports from Pakistan have grown by 62 percent and 65 percent, respectively.

Standards and non-tariff barriers

25. At a recent session at the 4th South Asia Economic Summit in Dhaka on trade in South Asia, the issue of regional trade cooperation figured prominently. The meeting resolved to focus on supply-side issues, which include rationalisation of standards and implementation of an effective competition policy and law. It is no secret that the cause of regional trade is mortgaged to Indo-Pak relations. Alas, recent incidents of two-way non-tariff trade barriers, though unconnected, only appear to stall the story. One was Pakistan's blocking of sugar exports from India, while India blocked cement

imports from Pakistan. And we wish to take the volume of trade from \$1.76bn per annum to \$10bn in the near future. Both those barriers were erected in the name of standards, but clearly, there existed vested interests behind them in the form of local producer cartels: sugar in Pakistan and cement in India.

26. India and Pakistan are signatories to the WTO's SPS and TBT agreements, and if these consignments are not in conformity with the stated standards, then officials have a right to hold them up. But if the same sugar is good for Indians and cement for Pakistanis, why the brouhaha?
27. On the other hand, both India and Pakistan argue at the WTO that there should be mutual recognition of standards and/or equivalence. If they cannot do so at the regional level, what right do they have to seek so at the WTO in Geneva? Whenever either party opens its mouth in Geneva at the negotiating table, someone points this out.
28. Thus, the way ahead is to start identifying minimum standards and safeguards which should have mutual recognition, taking into account existing standards in the respective countries, and possibly accept them as regional standards for trade within the region. Second, they should also adopt good competition laws to foster regional cooperation under the Safta framework. Once this is done, not only Pakistan and India, but the whole developing world can demand the same at Geneva.
29. Trade theory amply demonstrates that imports are an effective competition policy tool to reduce the local market dominance of domestic interest groups, a circumstance that delivers suboptimal outcomes which go against the interests of the consumer and economy at large. Domestic trade policy must never be held hostage to vested

interests, and a perspective of the larger national welfare must never be lost in devising trade and other policy instruments and practices.

Mutual trade is beneficial

30. Engaging in mutual trade brings benefits to all. This is not rocket science, and even the common man understands this. Pointers in this direction were offered by a recent opinion poll conducted simultaneously in India and Pakistan by The Indian Express in alliance with Dawn News and CNN-IBN, as also by an NDTV 24x7 debate held in Karachi and telecast on June 18, 2007 (“Indo-Pak: Generation Gap”): people on both sides of the border feel that friendship and cooperation (read trade) are a prerequisite for improving relations between the two neighbours.

31. There are examples across the globe of trade playing a positive role in conflict resolution between neighbouring countries. Even regional trade agreements (RTAs) that expand trade flows, as some studies indicate, appear to have a substantial dampening impact on conflict. Mansfield & Pevehouse (2000) found that the outbreak likelihood of a militarised inter-state dispute declines by around 50 percent if both belong to the same regional trade agreement. As an RTA, Safta can provide institutions and a forum for the bargaining and negotiations needed to address tensions before they erupt in conflict. The EU, Asean and Mercosur are often cited as venues for improved political-military relations. In Africa, RTAs that address the management of cross-border resource issues are more effective in reducing military conflict than other RTAs.

Cross border infra projects

32. Among other ways to promote economic cooperation is to look at cross-border infrastructure projects, which have opened prospects for economic benefits through cooperation. Regional cooperation projects have the potential to improve the well-being of all parties involved because of the scale of economies they permit, the complementarities between the economies, and the externalities they induce (multiplier effects, attraction of foreign investment, diminution of gaps, etc.).
33. Regional cooperation infrastructure projects have a potential for the improvement of the well being of all parties involved. The East-West Economic Corridor, a 1500 Km long highway project crossing 6 GMS (Greater Mekong Sub-region) countries in the Southeastern Asia connecting South China Sea to Indian Ocean and the Middle East regional cooperation projects are some good examples in this regard. In the same vein the mega-economic projects like the Turkmenistan-Afghanistan-Pakistan and the Iran-Pakistan-India gas pipeline projects would help in promoting trust and regional economic cooperation between India and Pakistan.

The 'K' factor and moving on

34. Skeptics would argue that in the case of India and Pakistan, the Kashmir dispute is sui generis and thus the improvement of relations is dependent upon its resolution. In this case, one can draw lessons from North Ireland, which has been a bone of contention between the United Kingdom and Ireland as well as a huge number of people living in Northern Ireland. The Irish Republican Army has agreed to lay down its arms, and has also stopped any terrorist activity either in Ireland or in the UK, after thirty years of conflict. Can the same not be attempted in Kashmir, which has become a similarly intractable problem between India and Pakistan as well among the people living in various parts of Jammu and Kashmir.

35. There are several lessons that can be derived from the friendship, cooperation and peace-making process across the globe. First and foremost, to be successful, an exercise of this kind must be based on a sincere purpose of reaching agreements to end nuclear race and/or cross border terrorism and establish a climate of mutual confidence. No moves in this field can have the slightest chance of success if they are taken with the ulterior motive of destabilising the other party or lulling it into a false sense of security. As a first step, a country should open itself to the other party, on the understanding that this policy will be reciprocated. Information should flow fully and freely from one country to the other. Of course, the climate of mutual trust thus attained will not last if flanking and additional measures do not follow to give it a permanent character.
36. Such additional measures include to keep talking: it's never over until it's over. Secondly, constructive engagement works better than pressure: Renewed efforts for willingness to support bilateral confidence-building measures would lead to more progress than diplomacy-based political criticism accusing each other for cross-border terrorism (which of course needs strong action by both the sides).
37. Some political observers are defining a new South Asia as a region where various types of freedoms can be realised — that is, freedom from want, freedom from fear, and freedom to live with dignity. This is premised on the axiom that every single individual on earth has both the potential and the right to live a decent life. Let us work for a new South Asia in 2007 and grab any opportunity for a long lasting peace following the examples in South America, Europe, and Southeast Asia.

Will there be a peace dividend if the cooperation is concretised?

38. There will be a huge peace dividend if trade relations are strengthened. When two countries trade with each other, people develop an interest in maintaining peace, so that the flow of goods and services is not disrupted. When countries are trading with each other, they avoid conflicts. If there are any disputes, as is likely to happen, they use dialogue to resolve them. What has been seen in many similar situations is that countries decide to maintain the status quo (somewhat like the LoC) and move on.

They always say one should learn from the lessons of history. We should also not repeat the mistakes that were made while history was being written.

Let's learn from the humble housewife, who seems to have more economic wisdom than the political masters of our countries. Buy from the cheapest source, in commercial language called "forum shopping", shopping from the most cost effective forum/source. After all we just happen to be neighbours. What if our politics makes a little noise!