

Rapid Briefing

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India-Pakistan Economic Cooperation *Current thaw and a pathway*

The history of India-Pakistan economic relations is one of the most politicised issues that has dominated not only the realm of South Asian politics, but has also been a source of considerable concern in the international arena. Notwithstanding the imperatives of bilateral cooperation and the need for countries to forge closer economic linkages with their neighbours, one of the serious roadblocks to effective functioning of SAARC (South Asian Association for Regional Cooperation) is, to a large extent, due to Indo-Pak tensions.

This *Rapid Briefing* explores the path towards better cooperation between these two countries. In doing so, it upfronts 'energy' as a significant building block.

Trends in Bilateral Trade

India and Pakistan have a history of bilateral trade relations. Bilateral trade between India and Pakistan was minimal since 1947. It picked up in 1988-89 with the increase in the list of approved imports from India and in 2003-04 there was a boom.

While the above-stated figures were official statistics, the value of unofficial trade is estimated as \$500mn a year. It has been found that Indian-made machinery (for textiles and tanneries in particular), spares and equipment are used in factories in Pakistan, but not directly imported from India. The large volume of unofficial trade is a pointer to trade complementarity and tremendous potential that exists between trade between India and Pakistan. It also shows huge revenue losses to both the governments.

Among tradable commodities, it has been found that Pakistan can buy machinery and steel items, chemicals and dyes, wheat, spices, tea and many other products from India, and sell cotton yarn and textile, leather products, surgical instruments, paper, vegetables and

fruits, among other things. There will be huge gain for consumers of both the sides.

A major concern about bilateral trade relation between India and Pakistan is fluctuation in two-way trade. This fluctuation is attributed to the vicissitudes of political relations. In addition, there are a number of non-tariff barriers and customs-related matters, which prevent more trade between these nations.

Business to Business Relationship

One particular issue, drawing attention, is to increase "business to business relationship" between these countries and, more importantly, within a composite peace-building package. Government of Pakistan has placed great emphasis on the inflow of foreign investment into the country. Many projects in Pakistan can now be set up with more than 50 percent foreign equity. Given this policy framework for foreign investment in Pakistan, the obvious question is, how far has this framework would be conducive towards facilitating Indo-Pakistan joint ventures. Exploring joint ventures should be the first step of efficiency-seeking restructuring of industries in these two countries.

The business community, in both countries, is keen to explore various possibilities. A business-to-business Joint Study Group was constituted under the aegis of India-Pakistan Chamber of Commerce and Industry. It has mapped out ten focus areas of cooperation, viz, agriculture and agro-processing, services, petrochemicals and chemicals, infrastructure, textiles and garments, engineering, gems and jewellery, lifestyle, large-scale industries like paper, cement, steel and sugar and investment and technology transfer. In services, the Group will work on areas like health, tourism, education, information technology, banking and entertainment.

| Trade Relationship between India and Pakistan (in \$ '000) | | | | | |
|--|---------|---------|---------|---------|---------|
| Year | 1999-00 | 2000-01 | 2001-02 | 2002-03 | 2003-04 |
| Pakistan's exports to India | 53,647 | 55,397 | 49,227 | 70,664 | 93,680 |
| Pakistan's imports from India | 127,383 | 238,337 | 186,891 | 166,571 | 382,122 |

Source: Board of Investment, Government of Pakistan.

Another area where cooperation is possible could be in providing better transit facilities for goods to move from India, through Pakistan, to Central Asian countries and vice-versa from Pakistan, through India, to other South Asian and South East Asian countries.

Energy: A Key Sector

From the history of economic cooperation between neighbours, it has been found that at times a small set of commodities and/or a single sector acts as a catalyst. In case of Indo-Pak economic cooperation, energy could be one such sector. Another condition for a successful cooperation is that there should be potentiality of investment, with significant forward and backward linkages with the economies. Energy fits this bill too.

At present, India is an energy-starved country and energy cooperation with Pakistan would enable it to optimise the use of this scarce resources. This will also foster better utilization of resources in sectors like hydro-electricity, wind energy in Pakistan. For example, Pakistan has surplus hydro-electricity, which can be exported to North-Western India. Though In 1998, Pakistan agreed, in principle, to export 300 megawatts of (hydro) electricity to India for 10 years, but this cooperation could not be materialised due to the failure to agree on tariffs. In the case of wind energy, India has an installed capacity of 900 megawatts, which could be shared with the Sindh province (bordering the Indian states of Gujarat and Rajasthan) of Pakistan.

Pakistan is strategically positioned in the oil geography of Asia and India, with its rising energy demand, cannot but acknowledge this fact as it sets out to tap natural gas from Iran and many Central Asian countries to transport it through pipelines via Pakistan. Given the current state of economic activities and expected increase in the future, both India and Pakistan would require large volumes of import to meet their domestic needs of natural gas. It would be economically more viable for them to construct a common pipeline to tap the deposits in the Persian Gulf and Central Asia than to go for separate ones. It is estimated that Pakistan can also earn up to \$500mn a year in transit rights. For Pakistan, this is a great opportunity to capitalise on its strategic position.

Recent development to foster better energy cooperation is a pragmatic acknowledgement of this

reality. The two sides have agreed to constitute a joint working group on hydrocarbon cooperation. They agreed to get the \$4.2bn Iran gas pipeline (a 2,700 km pipeline) project operational by the beginning of 2006.

Pakistan also stands to benefit if it lifts ban on import of diesel and other petroleum products from India. Indian Oil could export diesel to Pakistan from its Panipat and Bhatinda (situated in the Indian states of Haryana and Punjab) and Jamnagar refineries (situated in the Indian state of Gujarat). Major markets in Pakistan (Lahore and Karachi, respectively in the Pakistan provinces of Punjab and Sindh) are closer to these sources than the Gulf region.

Many analysts have argued that the viability of Iran-Pakistan-India gas pipeline is much more than that of the Turkmenistan-Afghanistan-Pakistan line. This viability is on account of economic, political and security factors.

If all goes well, the Iran gas pipeline would be a reality by the year 2010. At present, India needs 170mn cubic feet of natural gas per day and by 2020, the requirement would be 400mn cubic feet. If the economy grows at the same pace i.e., seven to eight percent, India is to face a huge energy deficit in the next 15-20 years. Pakistan will be in a similar situation and would also have to import to meet its energy demand. Thus, the issue is more economic than political.

In Lieu of Conclusions

It is too early to say that India and Pakistan should enter into dialogues for a free trade agreement (like the India-Sri Lanka Free Trade Agreement) or a comprehensive economic cooperation agreement (like the India-Singapore Comprehensive Economic Cooperation Agreement). The political situation calls for 'pilots' and their successful implementation in order to show communities the dividends that cooperation could bring. Creating an 'elephant' at this stage is not only difficult but not feasible as well as there exists blindfolded elements, which is a reality.

The challenge before the polity (and its broader elements, i.e. business, civil society) is to show to their composite communities the virtues of cooperation. Efforts should be made to accelerate and foster cooperation in sectors having greatest potential benefit for the citizens of these countries. Energy is one such sector and there are many more.