India-Pakistan Relations – Part Three: Economic and Cultural Aspects

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Key Points

- Bilateral trade between India and Pakistan is influenced by political trends.
- Those ties, nevertheless, show an upwards momentum.
- They require more attention, however, if they are to reach their full potential.
- The two countries are culturally similar, sharing similar languages, norms and institutions.
- With care, those commonalities could be used by both countries to mitigate adversarial frameworks.

Summary

As Parts One and Two of this study have shown, the India-Pakistan relationship is adversarial. This has been due to the legacy of a violent partition that witnessed inter-communal strife and, since then, the inability of various elected governments in Pakistan to fully control domestic and foreign policy. The two countries have, consequently, fought several wars that ended with no real result or in victory of sorts to India. Neither country has benefitted in any concrete term from these wars; it could be argued, in fact, that they have only served to constrain the economic development of India and Pakistan, irrespective of the
fact that India witnessed the elimination of the two-front threat posed by East and West Pakistan when East Pakistan became independent Bangladesh in 1971.

Bilateral trade and commercial ties have remained in place between the two rivals despite their various ups and downs, however. The partition of colonial British India not only divided the country’s territory, but also families who now found themselves on different sides of the newly established border. Partition could not, however, immediately remove or reduce cultural commonalities such as language, social norms, gastronomic tastes and other cultural ties. These divided families used their geographic locations to trade, sourcing products from both sides of the border and maintaining their cultural and familial ties. As the immediate effects of partition waned, Indian and Pakistani businesses began to recognise commercial opportunities in each other’s country, giving rise to more formalised commercial and cultural ties.

Analysis

Bilateral trade ties between India and Pakistan have undoubtedly remained hostage to the political vagaries of the relationship but only in a limited fashion. In 1948-49, for instance, India accounted for 56 per cent of Pakistan’s exports, this despite the sovereignty of Kashmir being disputed by both; Pakistan simultaneously sourced 32 per cent of its imports from India. India continued to remain Pakistan’s largest trading partner for the next several years, despite their deepening tensions. One indication of this is the fact that the two sides concluded fourteen trade agreements between 1947 and 1965. In 1965, the year the two countries went to war over Kashmir again, Indian banks continued to operate their branches in Pakistan. Following that war, however, and the degree of antipathy generated on both sides in the aftermath of the 1971 war, trade relations between the two countries all but came to a standstill for over eight years. The two countries came together again in 1972 and a protocol on resuming trade relations was signed in 1974. That trade was very limited, however, and conducted on a very small number of mutually agreed upon items.

There were, additionally, trade-related disagreements between India and Pakistan even when trade was conducted. In 1949, for instance, India decided to devalue the rupee believing that Pakistan would do likewise. When Pakistan did not, because it anticipated a substantial growth in commodity prices, India instituted an import duty on jute, which was one of East Pakistan’s most valuable exports to India. India argued that the combination of higher raw jute prices, coupled with the devaluation of its currency, would price jute beyond its reach. Pakistan retaliated by imposing restrictions on the importation of some Indian manufactured goods. It was soon believed by many in Pakistan that India was jealous of Pakistan’s economic growth. This led Pakistan’s Finance Minister, Ghulam Mohammad, to remark in his Budget Speech on 13 March 1950:

I regard it as highly unfortunate that, instead of facilitating the normal flow of trade between the two countries, the Government of India should have embarked on a boycott of trade with us. While fixation of the rate of currency is entirely a question for each country to decide with reference to its
circumstance, trade is a matter of prices. India, however, has taken the extraordinarily unfriendly step of boycotting trade with us. Judging from the fact that our trade with other countries continues to flow freely, I am led to the conclusion that India’s action is motivated by political rather than economic considerations. This is in line with a series of unfriendly actions in the economic and financial fields that [India’s] Government has taken against Pakistan since partition.

Pakistan had developed an import substitution policy in the 1950s, effectively the creation of a manufacturing base. This measure was responsible, in the main, for Pakistan’s economic growth of around six per cent for three decades. Bilateral trade was truncated, however, first by the war of 1965 and then the 1971 war. These two wars and, later, the civil unrest in Kashmir in the 1990s had a very detrimental effect on bilateral trade because they introduced a military element into what had been, until then, a purely commercial paradigm. In the interim, Pakistan’s manufacturing sector grew at double-digit rates, creating an influential manufacturing lobby that worked to shape the country’s trade policies. Given this growth and perceptions of advantage, bilateral trade, from the Pakistani perspective, was now seen in terms of “improvement in ground realities”. In other words, the industrial/manufacturing lobby felt confident enough to equate trade with India with political circumstances. They persuaded the precursor to the World Trade Organisation, the Generalised Agreement on Tariffs and Trade, to insert an India-Pakistan-specific special clause into the Text of the Generalised Agreement on Tariffs and Trade that relates to international trade to reflect this circumstance. Accordingly, Paragraph XXIV, clause 11 of the Agreement reads:

Taking into account the exceptional circumstances arising out of the establishment of India and Pakistan as independent states and recognising the fact that they have long constituted an economic unit, the contracting parties agree that the provisions of this Agreement shall not prevent the two countries from entering into special arrangements with respect to the trade between them, pending the establishment of their mutual trade relations on a definitive basis.

While this could be interpreted in positive terms, the reality was very different and tacitly referred to India’s poor economic growth rate, which gave rise to the pejorative “Hindu rate of growth”. The situation turned completely in the early 1990s when, following the collapse of its strategic partner, the Soviet Union, and realising that it would need to enter fully into the international community if it were not to become a failed state, India embraced international trade with both arms and, subsequently, saw its economy grow rapidly. Given its internal politics, Pakistan’s declined in comparison.

Reflecting, once again, the nexus between trade and political relations, India accorded Pakistan “Most-Favoured Nation” (MFN) status in 1996, according to which Pakistan would have the same trading rights with India that any other country has. This step was taken as part of the attempt by the two countries to lay the Kashmir issue to rest by the thirtieth anniversary of their independence. Pakistan continued to maintain limited imports from
India (its so-called “positive list” detailing the goods that could be imported), primarily to protect its manufacturing base. New Delhi terminated all air- and land-borne trade with Pakistan following the attacks on its Parliament in December 2001, which it alleged were carried out by Pakistani-based militants. That imposition remained in force until 2004. A restrictive maritime trade regimen was also implemented. As a consequence, informal trade between the two countries began, with trade occurring via third parties like Dubai, albeit at increased cost.

In 2004, the two sides came together for a dialogue on trade. That dialogue would eventually extend over four more rounds of talks but culminated in three outcomes in 2007: a land-based trade route was re-opened, the restrictions on maritime trade were amended and the positive list was enlarged. Pursuing “confidence-building measures”, the two countries also agreed to permit trade across the Line of Control (the de facto international border) in Kashmir. The ongoing dialogue was halted in the wake of the terrorist attacks on Mumbai and only resumed in 2011. It is interesting to note, however, that no drastic measures were enacted to stop or decrease bilateral trade over that period.

In April 2011, Pakistan initiated measures to grant MFN status to India and, in November of the same year, produced an itinerary to phase in that status. A major part of that process was for Islamabad to move from a positive list approach to a negative one, which would list only those items that could not be imported from India – around 1,200 products and items; for its part, New Delhi curbed its list of restricted imports from Pakistan to just over 600 in September 2012. New Delhi’s list of products that could not be imported from Pakistan, it was believed, would fall to around 100 by July 2013.

Bilateral trade between India and Pakistan is estimated to be around US$2.61 billion ($3.4 billion) for the 2015-16 period. From the Indian perspective, this is a very small part of its overall trade. It could be perceived, nevertheless, as a measure of the importance of trade in India.
the bilateral relationship that the two sides persist in ensuring that it continues. In the most recent instance of alleged cross-border violence, eighteen Indian soldiers were said to have been killed by militants who crossed the border from Pakistan in late September 2016. India retaliated by sending its troops into Pakistan to strike at what were claimed to be “launch pads” that militants planned to use to strike again at other Indian targets. While these actions caused much debate and calls for action against the other on both sides of their common border, it is noteworthy that even after the Indian Government said it would review trade relations, the MFN status it has given Pakistan and the terms of the Indus Water Treaty, nothing of the kind has eventuated. The volume of trade may be expected to fall in the aftermath of the September incident but, as the previous diagram demonstrates, the general trend of trade between the two countries remains upwards. This is borne out by the following diagram, which also indicates that while political events such as the one described can cause a downturn in trade between India and Pakistan, those ties resume and even grow once the initial anger and furore has died down.

Impact of Violence on Trade Ties Between India and Pakistan

The need to maintain the basis of a good relationship and the impact of violence on bilateral trade aside, pragmatism prevails. Both sides recognise that bilateral trade has the potential to reach US$30 billion, ten times its current value. Beguiling though that thought may be, Pakistan has found it difficult to reduce its negative list, partly due to the influence of its manufacturing sector. It, furthermore, wants India to reciprocate for the MFN status that Islamabad has offered it by reducing the so-called non-tariff barriers that include strict licensing rules, inspection rules and the subsidies offered to Indian farmers. Given the delicacy of the current situation in India, particularly in terms of farmer suicides due to crop losses, it is difficult to see how the Modi Administration could satisfy that particular condition.
Recent events have brought another impediment to potentially closer trade ties between the two neighbours. China, in its quest to garner additional energy sources that may not be subject to the security issues that could potentially bedevil its energy imports that pass through the Strait of Malacca, has agreed to fund the construction of an oil and gas pipeline that begins in Iran’s eastern Balochistan province, passes through Pakistani Balochistan and the Punjab and terminates in China’s western province of Xinjiang. While China’s usual maritime energy routes will continue to pass through the Malacca Strait, this pipeline could obviate the security threat that a modernised Indian Navy could pose to Chinese energy imports. China has, therefore, offered Pakistan to invest around US$40 billion ($52.5 billion) to develop this pipeline and additional economic infrastructure. The size of this investment has caused Pakistan to re-evaluate its trade links with India and, finding those relatively insignificant, has opted to concentrate on building the pipeline.

India, for its part, has entered into an agreement with Iran to develop the latter’s Indian Ocean port of Chabahar. This gives it access to Afghanistan and the Central Asian republics, bypassing Pakistan, which could, consequently, lose its immediate salience to India. These two factors, coupled with the ongoing antagonism, have the potential to disrupt the pursuit of bilateral ties by both countries.

India and Pakistan share common cultural values in addition to divided families. The Indian film industry has a large following in Pakistan and Pakistani actors participate in Indian television programmes. Cricket is yet another common factor. The game is closely followed in both countries and approaches something of a religious fervour in India. While matches between India and other countries are issues of importance for most urban and semi-urban Indians, matches between the Pakistani and Indian cricket teams approach a war footing, with strategies and tactics discussed in infinite detail. A loss by either side is viewed as a disgrace by the losing country. So competitive are these matches and so susceptible to security concerns are they that it has been proposed that some of them be held in third countries.

Given the frequency of violent attacks on each other’s territory, it is difficult to remember that India and Pakistan share many commonalities. It may not be too far from the truth to suggest that they have more in common than they do differences. Given this, it behoves them both to pay more attention to formulating strategies for their mutual benefit. They could, for example, create “economic zones” along their common border to facilitate enhanced trade or even better people-to-people contact. While it is difficult to see this occurring in the near term, moves to facilitate better trade and people relations could only produce positive longer term outcomes in what continues to remain a dangerous region of the world.

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