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The great trade bounty

By Dr Asad Sayeed

The recent visit of Commerce Minister Makhdoom Amin Fahim to New Delhi may well be the harbinger of some good news on the economic front after a long time. Reports from New Delhi suggest that Islamabad has agreed, in principle, to accord India the status of Most Favoured Nation (MFN). It just means that Pakistan will treat trade with India at par with trade with other countries. The two countries also agreed to initiate banking facilities to help boost bilateral trade –which currently hovers at around $2.0 billion annually– and enhance it three times over in the next three years. Moreover, India assured Pakistan that it will not oppose preferential trade access to Pakistani products in the EU region if Islamabad accords it the MFN status.

If Pakistan-India trade relations – severed in 1965 – are normalised, it will open up a hitherto stalled growth node for the Pakistani economy. There have been several models of growth propounded throughout Pakistan's history, but none actually created a growth impulse which lasted long enough to bring about a marked transformation in Pakistan's economy.

The share of manufacturing as a proportion of GDP has remained in the range of 17-20 percent for the last 40 years and two-thirds of Pakistan's exports have been driven by the cotton sector and rice exports. Former premier Zulfikar Ali Bhutto's state-driven policy framework in the 1970s to the market-based economic model adopted in the 1990s failed to alter this fundamental reality. If we observe other countries that moved from low-income to middle- and high-income category, we see that this transformation has been accompanied by structural changes in both the share of manufacturing increasing as a proportion of GDP as well as the structure of exports moving in the direction of non-food and non-textile value-added products. To hope that some magic wand will bring about the desired structural change is likely to waste more time.

So, if we are unable to alter the existing economic structure, what is the way to maximise growth? The most promising possibility in this situation is to enhance regional trade. Due to similarity in tastes and preferences, regional trade creates possibilities for trading in those items that are often considered non-tradable and are meant exclusively for the domestic market. Low transport cost and low unit values of production in both India and Pakistan, compared with the developed economies, enhance the possibility of increased volumes of trade between them.

Pakistan's two biggest industries remain textile and food processing. Both these industries will find a ready market in northern India because of similarity in tastes and preferences. Pakistani lawn and lawn garments, for instance, are popular in India. If Pakistani lawn products get a market five times larger than its own, it can provide a massive boost to the country's textile and garment industry. Similarly, Pakistan's processed quality spices and confectionary industry cater to the taste of Indians and can hold grounds in the Indian market.

Beyond tastes and preferences, transportation costs due to proximity also matters. If Pakistan and India trade normally, then a number of agricultural products and by-products that are still traded, such as vegetables, will benefit from the improved infrastructure and procedures. If road and rail links through Wagah and Attari are developed, export of molasses from Pakistan – to name one item - will procure a large market on the other side of the border.

The trade will increase not just in the existing industries and current capacity, but Pakistan also stands to benefit in energy trade with India. Given India's rapid growth, it will remain an energy deficient country in the short- to medium-term. Notwithstanding Pakistan's present energy woes, it has a large potential to export electricity once Thar coal comes on stream and provides a corridor for supplying natural gas to India from Iran and Central Asia. Opening up of the trade corridor to Central Asia will also mean that India will have a cheaper route to ply its growing trade with Central Asia through Pakistan. Revenue earning possibilities for Pakistan through this channel may be transformative in its own right.

Normalisation of trade relations will also enhance revenues in the narrow fiscal sense given the high level of informal trade. Because a number of Indian products that are not on the list or permissible import items have a ready market in Pakistan and some vice versa, it is estimated that the informal trade in the vicinity of $2.0 billion takes place between the two countries. If this trade is legalised, it will have a positive impact on fiscal revenues as both customs duties and sales tax on imports will increase commensurately.

More than the above mentioned static picture on gains from trade in the region – common to most regional trade partners – we are fortunate to not just have a large neighbour we can trade with but one that is among the fastest growing economies in the world and along with China is likely to remain the hub for global growth and development in the coming decade. Benefits of trading with India will accrue in the realm of reducing the unit value of industrial imports as well as offer the possibility of large investment inflows in the country.

Many fear that Pakistan will run a huge bilateral trade deficit in case of normal trade with India. Even if this is true, it is estimated Pakistan's aggregate trade deficit will reduce by $1 billion as a wide array of industrial raw materials and machinery imported from the West or East Asia will then be imported from India, where not only the unit costs of these products remain lower, but it's much cheaper to transport them from the neighbour.

The biggest benefit, however, of improved trade relations will be of investment inflows from India into investment-starved Pakistan. Take the example of Thar coal. One reason for the slow pace of its development is the prohibitive sunk cost in translating the natural resource into marketable electricity production. If India will also benefit from the development of this facility, it will have an incentive in investing, both financially and technologically, in getting electricity production off the ground from this facility. Net gains in a dynamic sense from normalising trade and investment relations with the giant neighbour, many of us love to hate, are boundless.

If economic benefits from trade with India are so immense, it is pertinent to ask why Pakistan did not avail this opportunity for so long? Geo-political rivalry lies at the centre of this lost opportunity. However, up until the 1990s, the prevalence of protectionist policy – the concept of developing local industry behind high tariff walls – also created a business elite that did not wish to compete with the other more powerful economic entities. And this was the dominant framework in both countries – perhaps more in India than in Pakistan. But after trade and economic liberalisation in the 1990s, where countries freely trade with each other under global rules – formalised by the WTO – there is no basis for discriminating against India. After all, India cannot damage Pakistan's industry or economy more than other powerful trading partners such as the United States, Germany or China.

This thinking has gradually seeped into Pakistan's business community. Most of the regional chambers of commerce and the Federation of Pakistan Chambers of Commerce and Industry as well as the Pakistan Business Council (PBC) endorse trade with India. More importantly, Pakistan's five largest political parties in terms of vote share – the Pakistan Peoples' Party, the two major factions of Pakistan Muslim League Nawaz and Quaid-e-Azam, the Awami National Party and the Muttahida Qaumi Movement – endorsed normalisation of trade with India on April 29, 2011 at a forum organised by the PBC.

This essentially leaves the religious parties and the armed forces as the only protagonists objecting to normalising trade ties with India, based on historical geo-political adversity between the two countries. It needs to be underscored, however, that territorial disputes have not prevented other countries from trading with each other. China trades with India as well as Taiwan without compromising on its territorial claims. Pakistan can also keep its geo-political disputes alive and still trade with India. Normalised trade relations will help prevent armed conflict between the two states.

It has been said that Pakistan's recent commitment to grant India the MFN status came following its 'clearance' with 'all relevant stakeholders'. In all probability this means that this clearance has come from the military. Nothing can be said for certain, till the agreement gets signed. But if this is the case, then we may have turned an important leaf in Pakistan's statecraft also. As noted security analyst Dr Ayesha Siddiqa recently wrote that this will mean that Pakistan can move towards creating a new form of 'strategic depth' by means of securing its economy and delivering prosperity to its people. Let's wait and see.

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