

Why SAARC remains Dormant – A Focus on the Hindrances in Indo-Pak Trade Relations

Ishneet Kaur

B.A. (H) (III)

Kirori Mal College

Even after the formation of SAARC trading bloc in 1985, regional integration among the South Asian countries remains minimal. This article examines the reasons to the same while focusing upon the two largest economies- India and Pakistan.

The classical trade theories imply that the trade should occur only between capital rich developed countries like the U.S. and labour rich developing countries like India. Why then do we see a huge amount of trade occurring between similar resource-rich countries of U.S. and Canada? The line of argument taken up in other theories opposes the one taken by previously mentioned trade theories and implies a contradictory result of greater trade flows between similarly endowed SAARC countries.

Trade potential wherein member states have a comparative advantage in distinct sectors also exists in South Asia. However, for example, India's import complementarity with other members' exports has been low. The presence of large Sensitive Lists is largely quoted as an impediment to growth of intraregional trade flows.

In 1995, the seven South Asian countries – Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan, and Sri Lanka – initiated a multilateral framework for region-wide integration under the South Asian Preferential Trade Agreement (SAPTA). Following SAPTA, the South Asian Free Trade Agreement (SAFTA) commenced in 2006, envisaging a duty free area by 2016 for all Member Countries. However, the success achieved under the treaty has been quite limited

As far as Indo-Pak relations are concerned, historically, the trade flows between the two countries has been highly significant, interrupted by a rapid downturn at the end of 1949. The reason for diminishing India-Pakistan bilateral trade significance is not tariff barriers or quota problems, but informal trade between the two countries, which is generally carried out by (1) rerouting trade through a third country (such as the United Arab Emirates, specifically Dubai) and (2) illegal trade through land borders. Pakistan had promised to grant India the most favoured nation (MFN) status by the beginning of 2013, a status that India had granted Pakistan in 1996. Essentially, this meant that as of 2013, restrictions on imports from India would have to be eliminated which is seen as a positive step towards regional and economic integration. However, with recent untoward incidents at the Line of Control, the process of granting MFN status were put on hold and the informal trade is also expected to rise.

Trade potential – Foregoing gains

Trade flows between the two countries hold immense potential. The gains from trade are studied on an aggregated as well as a disaggregated sectoral level.

Actual-to-potential trade ratio: The ratio of actually realised to potential trade computed on the basis of gravity model. The APT ratio for India's exports to Pakistan is only 0.02, while that for Pakistan's exports to India is still lower, 0.01. Expressed inversely in potential-to-actual trade terms, the potential of formal trade between India and Pakistan is roughly 20 times greater than recorded trade.

Sectoral Gains: Trade is carried out only when there is a net gain to be reaped for the society as a whole, i.e. the gains from trade outweigh the losses from the same. Looking at the sectoral gains and losses arising from Indo-Pak trade, the findings are as follows: First, Pakistan will gain from access to advanced technology and machinery from India. Second, it is likely that the pharmaceutical and automobile industries will lose out to more competitive Indian industries. Third, the agricultural sector could benefit if it is allowed to compete on a level playing field; at present, India's heavily subsidized agriculture makes Pakistani products uncompetitive. Fourth, certain sectors like textiles, electric fans and tyres will gain from trade with India because of its large market as well as Pakistan's geographical proximity to certain regions of India, as compared to some of the Indian states producing these products. Similarly, India stands to gain in sectors like tea, auto parts, light engineering.

Intra-industry trade: Intra-Industry Trade (IIT) within the region which is referred to as the trade that occurs when a country simultaneously imports and exports similar types of products within the same industry or sector. Two sectors - textiles and clothing and automobiles have a high potential for intra-industry and intraregional trade and integration.

Non-tariff barriers (NTBs)

Specific to the case of India-Pakistan trade relations, the non-tariff restrictions are put up at each stage to discourage the movement of goods across borders. There is also an allegation that some NTBs are levied by India only against goods from Pakistan in an ad hoc manner. These NTBs include lack of proper infrastructure, inefficiencies that persist in the absence of cross-border transport agreements, visa difficulties as well as technical barriers to trade in terms of phyto-sanitary measures. This issue needs to be addressed by developing a system of consistent treatment over a longer time period.

It appears that while there are widely heralded attempts being made to dismantle "official" trade hurdles, other barriers are being added to maintain the status quo, specifically in those sectors where Indian interests are most threatened by Pakistani exporters, such as cement and textiles. The field-level or lower bureaucracy on both sides of the border has been highlighted as a major NTB. Such hindrances and ad hoc behaviour to cross border movement of goods are a result of political tensions between the two countries and the suspicion that the governments and bureaucracy in both countries have for each other.

Global value chains

The cross-border production chains in which the raw material extracted in one country may be exported to a second country for processing, then exported again to a manufacturing plant in a third country, which may then export it to a fourth for final consumption are referred to as Global Value Chains (GVCs). The recent phenomenon of the production process being spread across the globe goes a long

way in defining the global trade patterns and becomes an important determinant.

In recent years, the South Asian countries have been showing the greatest growth in GVC participation. For South Asia the upstream links (foreign value added, i.e. the use of foreign inputs in exports) remain very low whereas downstream links (exports that are incorporated in other products and re-exported) are quite significant in GVC participation. This emerges as the consequence because India has a major service led GVC participation which does not use any imports (low upstream links) and countries like Bangladesh and Pakistan produce electronics and automobiles components which are exported to be assimilated in other countries (high downstream links). The working of the GVC then makes it difficult for trade flows between the member nations. Also as most of these GVCs are operated by the big firms of U.S. and Europe, it reiterates the amount of extra-regional trade flows from the South Asian region to these countries. The growing precedence of the GVC in defining trade flows explains the low level of trade between the member countries, for it is the economic power of controllers of GVC which creates trajectories and path dependencies, where the countries get locked in, and to create an alternative regional trade paradigm becomes difficult.

Politics at play

Since trade flows between countries always create some winners and losers, the sectional groups have an influence on the trade relations as they lobby for protection of their interests and pressurise the government to hinder beneficial trade flows. This happens because as consumers, people are not aware of the margin of lower costs of the goods had it been imported but

the producers are very well aware that imports have the potential to wipe them off entirely and hence, have more incentive to form lobbies. The other considerations include whether the sector being harmed has a large employment base and if it is so then the flooding of markets with imports will have the potential to decrease the domestic employment as the domestic producers would shrink in size. The employment losses would lead to a loss in aggregate income and a consequent loss in consumption demand which would lead to a vicious cycle resulting in a further fall in income. The overall effect on the economy, then, is an important of consideration of the willingness to trade.

It has been argued that one of the reasons for SAFTA being ineffective is the large Sensitive Lists maintained by member countries. Such items are not offered concessional tariffs. The rationale for any negative or sensitive list in a preferential or free trade agreement is to provide protection to sectors considered unfit for competition (the infant industry argument). However, it has been observed that often, during the process of stakeholder consultation, sectors with strong domestic lobbies seeking protection get included in the list. Sensitive lists, particularly in the case of India have come to be dominated largely by such sectors. According to the tariff liberalisation programme under SAFTA, member countries are required to review the list for reduction every four years or earlier, as established by the SAFTA Ministerial Council (SMC) but there is no formal or binding commitment. Hence, the reduction of sensitive lists becomes a voluntary decision by each member country which is in turn decided upon by the degree of influence of such interest group lobbies.

Hence, it becomes imperative to take into account the interplay of the various factors

that hinder trade between the SAARC countries and go beyond formal trade relations.

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