

## **The Impact of Economic Globalization on India-Pakistan Trade Relations**

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### **ABSTRACT**

Economic globalization born in the ashes of WWII with the establishment of Bretton wood Institutions i.e., the International Monetary Fund (IMF) and the World Bank. These sister organizations brilliantly laid down the foundation of global trade aimed to avoid the great depression which the world had met worse in the 1930s. The creation of the General Agreement on Tariff and Trade (GATT) in 1947 and later on the World Trade Organization (WTO) in 1995 made it essential, for nation-states, to participate actively in the global multilateral trading system. This research paper analyzes the impact of Economic Globalization on India-Pakistan trade relations. This paper is divided into two sections, first section analyses the historical evolution of economic globalization and its key characteristics and the second section describes the developments in India -Pakistan trade relations that occurred due to the global economic scenario.

**Key Words:** Economic Globalization, WTO, IMF, World Bank, India, Pakistan, & Trade Relations

### **Introduction**

Economic globalization became the world order after the institutionalization of global economy. Liberalism was considered the only way forward to rehabilitate the war-torn global economy in post-world war second scenario. Under the influence of liberal economic theory, global policy makers, after the series of meeting during the onset of World War Second, agreed upon to establish international financial and trade institutions to develop the global set up of international economy in post war period. Consequently, two Bretton Wood institution, IMF and WB, came into being to regulate the international finance and monetary policies. An agreement with the name of General Agreement on Tariff and Trade was also signed to make policies for trade liberalization. Later, the GATT worked as an ad hoc trade organization and facilitated international trade negotiations while it replaced by its successor organization.... World Trade Organization (WTO) in 1995. WTO is single body organization to deal exclusively with the international trade matters. It makes policies to strengthen globally

integrated multilateral trading system through facilitating liberal trade (Tariff less trade). Implementation of WTO rules and agreements are binding on its member countries and are subject to punishment in case of their violation (WTO can be authorized to impose economic sanctions on such states who do not abide by its rules). The Structural adjustment policies of IMF and World Bank along with WTO's rules of 'Most Favored Nation' and 'National Treatment' brought immense changes in the economic relations of all regions and countries. These global circumstances also effected the trade relations between India and Pakistan. The two countries had to modify their micro and macro-economic and trade policies. This study describes the evolution of India-Pakistan trade relations in the purview of economic globalization.

### **The historical economic evolution of economic globalization**

Economic globalization is the outcome of liberal economic practices on a global scale. A liberal economy or liberal economic system is based on "Free trade, private ownership of the means of production and open competition" (Adams, 2001). On contrary to a planned economy, a liberal economy (it is called market economy also) relies on the market forces in the matters of import and export's decisions and the price mechanism, it discourages the role of the state in regulating trade and market-related matters while planned economy strongly acknowledge the supremacy of state on economic, market and trade-related matters. However, the system of liberal economy emerged in the reaction of mercantilism.

Mercantilism was basically a popular political doctrine from mid-1400s DC to mid-1800s DC, (Frieden, 1997) it restricted the laissez-faire (free trade) practice in trade and gave immense importance to the balance of payment surpluses to maximize the state's economic power. So, mercantilist philosophers were the strong advocate of governmental control over market forces. They emphasized that states should regulate the imports, exports, and trade between the states. They only permitted the import of raw material. That political ideology led the world towards colonial regimes. Mercantilist order was dominated by the European capitalist states and was the first international economy that was controlled by the European. The order supported the systematic intervention of the governments in the domestic market and especially in the international economic transitions.

Since the early 19th century, the mercantilist doctrine came under strong criticism in Europe, particularly in Great Britain especially after the popularity of Adam Smith's work. Adam Smith was a Scottish philosopher and he wrote a book under the name of "An Inquiry into the Wealth of Nations" in 1776. In his work, Adam Smith illustrated his theory of division of Labor that brought a revolutionary change in industrial capitalism. He gave more importance to consumption rather than the production of any commodity that changed the direction of the economy; it broadened the scope of economies. So, Britain eventually followed the liberal writings of Adam Smith and adopted the Laissez Faire policies (economic liberalism and free trade) in 1846 in the abolition of the Corn Law. And first time

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in her history allowed the import and export of grains that were previously blocked by Britain during Napoleonic wars. After some time, other European powers also followed the example of Britain. And they started to open up their borders for foreign products. That was the period when Britain has dominated the world economy. It was ruling over the sea through its strong naval powers and was directly controlling one-fourth of the world's territory. So, Europe adopted economic liberalism under the leadership of Britain that lasted from the 1860s to 1879 (Batool, 2018). During that period "England succeeded in creating an all-embracing world system of virtually unrestricted flow of capital, labor, and goods. Only the US remained systematically protectionist, though it slowly began to reduce its duties in 1832 continuing to 1861, and again between 1861, and 1865 during the civil war" (DeLong, 2001).

However, the Laissez Faire order reversed in the last decades of the 19th century, among variant other causes, the decline of British hegemony was the greater cause of that reversal. The first Great depression (1873-1890) and a new wave of industrialization led the global economy to a new wave of protectionism. European states started to protect their domestic manufacturers from foreign competition and they imposed restrictions on imports. That was the revival of the mercantilist approach which increased formal colonialism. Germany and France both followed Britain's example and joined the colonial race. In 1879, about 67% of the world's territorial area (that included Latin America, Africa, the Pacific, and Asia) had been colonized by the Europeans. Till the second decade of the 20th century, that figure rose to 84.4% (Frieden J. &., 2000).

From 1914 to 1918, Europe witnessed terrible devastations due to the outbreak of the First World War, among other things; the race for colonies between the major powers of the time was the main cause behind that war. Britain and its allied European powers had to borrow money from American commercial banks to buy food and weapons during the war period. The new wave of industrialization started in America during the war years due to the increased demand for American products in Europe. Factually, WWI weakened the economic and political position of Europe; as a result, it changed the political order of the world that previously was influenced by Great Britain. The leadership that was previously exercised by Britain was now divided between the Britain and USA. That downfall period of Britain brought unexpected opportunities for prosperity for the USA. During the war period, Europe did not pay much attention to its overseas economic activities. American businessmen took advantage of that situation and captured those overseas markets to sell their products.

American corporations and banks continued to expand their overseas business activities rapidly. At the end of WWI, America's volume of manufacturing goods was two times larger than Great Britain (Kennedy, 1988). American economic power was consistently rising in the post-WWI regime and by the end of WWII, America was the largest producer of the manufactured goods. In the post-WWI period, Europe was trying to rebuild itself from the devastations of the war. For that purpose, Europe established the League of Nations but America adopted the

policy of isolationism and refused to join the League of Nations. However American stock market crashed in 1929 and the world economy moved into a second great depression (it refers to an economic situation that occurred after the decline in world trade and the demands of goods affected negatively during that time). Protectionism was at its full swing and the world had been divided into rival trade blocks (Oatley, 2004). The United States of America increased its tariffs over near about 20,000 foreign products in the Smooth-Hawley Act of 1930. Europe, soon, followed the example of the United States and established a trade block, the Imperial Preference System (IPS) in 1932, based on the principle that “home producer’s first, empire produces second, and foreign products last.” (Richardson, 1936). That wave of protectionism fell the volume of world trade from \$35.6 Billion (in 1929 when the depression hit) to \$11.9 billion in 1932. The increase in protectionism indulged the world in bitter trade and currency-related conflicts and made impossible the international recovery from economic depression.

However, in 1934, US President Franklin Roosevelt initiated bilateral trade agreements with the consent of congress and the US passed the reciprocal trade agreement act RTTA in that regard (Oatley, 2004). That act, the first time, showed American intentions to exercise her leadership in the global economy. Under that act, the USA signed 19 bilateral treaties based on underlined principles... reciprocity and non-discrimination, later in the post-WWII regime, those principles became the central components of liberal economic order. After the Second World War, Britain was not able to handle its largest empire; the same case was with other western European states, so it started to close its overseas colonial engagements.

The process of decolonization resulted in the emergence of several newly independent states in different continents. On other hand, America was in the position to lead the world politically as well economically. Though the American government had decided in the 1930s that the American industry would capture the world markets under the RTTA act it was not successful to liberalize international trade yet, due to the world protectionist regime. "American Council on Foreign Relations, hence, organized a meeting of corporate representatives from private sectors and foreign policy officials from the public sector, jointly discussed how to formulate such policy framework which can serve to the economic vested interests of the American public and private sector" (J. Mander, 1996). The USA, in 1942, started its negotiations with Britain to formulate the post-war trading system. Those negotiations continued periodically till 1945. In that perspective, a historic conference at Bretton wood was hosted by the USA to develop a consensus on the post-second World War Financial system. At the end of that conference, two famous Bretton Wood institutions were established namely, the World Bank (WB) and International Monetary Fund (IMF). Both institutions played a key role in the spread of economic globalization.

IMF and World Bank pressurized third-world countries to open up their borders for international trade. Through their Structural Adjustment Programs (SAPs) in third-world countries, they paved the way for privatization and market

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economy. Besides the establishment of those two Bretton wood institutions, the USA was also ambitious to create an international organization to deal with trade-related disputes and regulate international trade. The United Nations, at its first meeting of the Economic and Social Council, set up a preparatory committee to formulate the charter of an international organization for international trade (Little, 1991). Further, the USA was negotiating with its European allies for multilateral agreements for the reciprocal reductions of tariffs on trade in goods. Further, the USA was negotiating with its European allies for multilateral agreements for the reciprocal reductions of tariffs on trade in goods. Meanwhile, in 1947, America became successful to develop a consensus among eight countries for reciprocal trade reductions and signed the General Agreement on Tariff and Trade (GATT). Those eight countries were the USA, UK, France, Canada, Australia, Belgium, Netherland, and Luxemburg (Zdouc, 2013). That agreement was created to form a broader International Trade Organization (ITO) that could facilitate free trade. For that purpose, the document for the formation of the ITO was negotiated at Havana Conference but it could not come into force due to the opposition of the American Congress. However, some parts of those documents became, later, the part of the GATT agreement at the end of the Havana Charter.

From the platform of GATT, trade negotiations are held among the states periodically. During the first five rounds of the GATT's trade negotiations, reduction of the tariff on trade in goods was the central theme while in the seventh round (Tokyo Round 1973-1979) non-tariff measures to trade were negotiated. The Uruguay Round (1986-1994), comprehensively negotiated the tariffs and non-tariff measures in goods and services and approved the sanctity of intellectual property rights. The first six rounds of negotiations of GATT were held, mainly, among the developed countries. "The developing countries participated in large number, for the first time, in Tokyo Round (Seventh round of GATT trade negotiations). The results of the Tokyo Round were included in the agreements (commonly known as Tokyo Codes) which were not ab initio binding on the countries" (Batool, 2018). Countries were given rights to adopt those codes if they agreed to the terms and conditions that were included in the Tokyo Codes. The initial signatories of that code had preferential rights and also had the right to decide the fate of those countries who later intended to become the signatories of GATT.

The eighth round of trade negotiations (the Uruguay Round) was concluded in Marakish in 1994 that created the first-ever World Trade Organization (WTO) that replaced the ad hoc organization ...GATT while the GATT agreements remained continued. The WTO took responsibility to administer those agreements. The WTO was not a simple extension of GATT it was more than that. It had a mandate to regulate global trade and legally decided trade-related disputes. The most important trait of the WTO was it had the authority to impose economic sanctions on those states that refused to follow its laws. One of the main objectives of WTO was to co-operate with the World Bank and IMF to make a coherent global policy of trade and development. WTO was based on two underline principles -- Most

Favored Nation (MFN) and National Treatment (NT) to liberalize free trade and minimize trade discrimination among WTO member countries. MFN, on the contrary of its literal meaning, was the policy of non-discriminatory trade practices of WTO that ensured that each member country of WTO would give equal preferential treatment to all its co-members in trade matters without any discrimination, and all WTO members will be considered equally Most Favored. But WTO allowed some exceptions for the developing countries. The developed members of WTO can grant preferential treatment to developing countries (who are the member countries of WTO) in trade matters. Moreover, the national treatment principle of WTO emphasized the equal treatment of imported and locally produced merchandise products in the domestic market of each member country. The same treatment should be applied to foreign and domestic services, copyrights, plants, patents, and trademarks (Batool, 2018). The charge of the customs duty imposed on imports was allowed and not considered a violation of the NT clause.

Since its creation, eleven ministerial conferences of the WTO had been held and its membership has increased to 160. The World Statistical Review shows that the export of manufactured goods increased from the US \$ 8 trillion to US \$ 11 trillion in 2016. While WTO members account for 98.2% of the world merchandise trade (WTO, 2017).

### **India- Pakistan trade in global economic scenario**

India and Pakistan both have never enjoyed the cordial relationship with each other due to pre-partition deep-rooted grievances and crucial border issues. They fought four fatal wars on the issue of Kashmir. However, in many ways, both countries have global significance because both are nuclear powers and situated in South Asia that has strategic significance for global power, and rich in natural resources. In terms of demography, market size, and area India is bigger than Pakistan. Global competitive Index (2017-2018) shows that India constitutes a 1,309.3 million population and US \$ 2,256.4 billion GDP. While Pakistan has a 193.6 million population and a US\$ 284.2 GDP. In this way, India is the 40th largest economy while Pakistan ranks 115th out of 137 economies (WEF, 2017). Despite the large difference between economic indicators (table) both countries have almost the same problems relating to the business environment, for example, poor trade infrastructure, inflation, and restricted labor regulation, inefficient bureaucracy, and high crime rate, etc., (WEF, 2017).

Though both countries are connected through the 11th longest international border in the world the volume of bilateral trade between the two remained quite low for a long time. Even it completely halted during 1965-1974 (Zaidi, 2006). During the initial two years after its creation, the destination of 56% of Pakistani trade was India while Pakistan imported 32% of its total imports from India (Tabish & Khan, 2011). India imposed a trade embargo on Pakistan in 1949 on the decision of the commonwealth on the issue of currency devaluation. On contrary

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to the Commonwealth decision Pakistan refused to devalue its currency concerning pounds sterling that affected the India-Pakistan trade relations (Khan M. , 2013). However, both countries signed 11 bilateral trade and payment agreements from 1948 to 1960 but unfortunately, it could not boost up the volume of bilateral trade (PHD-CCI, 2013).

Trade relations between the two countries were halted for nine years from 1965-1974 due to hot politics over Kashmir and Mukti-Bahini Movement. They fought two wars with each other in 1965 and 1971 respectively. Trade embargos were imposed from both sides on the border. On the other hand, the spread of economic globalization was increasing the economic dependence of all participating states of liberal trade systems (India and Pakistan both were initial signatories of GATT and was the part of the multilateral trading system) in economic matters especially in trade, capital flow, migration of the labor forces, and exchange of information and communication technology that affected the production chain and accelerated the process of internalization of economics. For instance, states were, at a time, eager to attract foreign direct investment within their territorial boundary and ambitious to expand their domestic capital abroad. (Batool, 2018). To make the global economic challenges both countries tried to reconcile with each other to normalize political tension and resume bilateral trade ties. So, Shimla Accord (peace treaty) was signed between the two countries in 1972 that restored commercial relations between India and Pakistan. Moreover, the government of Pakistan allowed its private business sector to trade with India that was promised to be effective from 1976[ (Dixit, 2003) & (Bureau, 2013)]. But Shimla Accord could not get the expected results in commercial relations due to the Indian nuclear tests in Pokhran in 1974. In reaction to the Pokhran test, the government of Pakistan decided to start its nuclear program on an immediate basis to maintain the balance of power with India.

The trade negotiations between India and Pakistan resumed during the Zia regime when Pakistan decided to join the Delhi International Trade Fair (1981). India reciprocated and its trade delegation visited Pakistan in 1983. Both countries constituted a joint commission to formulate the model of bilateral trade. That was the period when the trend of regional integration was at its full swing and various regional trade agreements were signing in different parts of the world to meet the challenges of economic globalization imposed by GATT.

Factually, economic globalization had weakened the Westphalian system, and states were lost their absolute sovereignty over their economic subject due to integrated economies. So, no state was able to cope with the challenges of the liberal market economy alone. Developing countries realized that the global economic system for the fragmented third world would prove sinister. To raise their voices collectively at the forum of GATT, to save their economic interests from the encroachment of developed countries, they decided to go for regional integration. On the other hand, developed countries also decided to signed bilateral free trade agreements and created regional trade blocs parallel to GATT for the rapid growth of trade liberalization in the entire trade blocs to boost up the process

of trade liberalization in the entire world. In that scenario, European Union (EU) had emerged as a successful regional trade block; USA followed the example of the EU and signed NAFTA (a free trade agreement between the USA, Mexico, and Canada). The trend of regional trade agreements (RTAs) became viral in the world. Initially, that trend confided to 'North-North' model (developed countries signed RTA with each other) while that trend went to the 'North-South' Model in which developed countries signed RTAs and bilateral or trilateral free trade agreements with developing countries and the next trend was 'South-South' model in which developing countries signed RTAs with other developing countries (ASEAN was the best example).

Indeed, India and Pakistan both were part of the global south (the term is used for all developing and least developing countries of the world due to their semi-industrialized economy, low saving rate, poverty, and socio-economic instability) and they were founding signatory of GATT. Both countries, in described above global economic scenario, agreed to go into the settlement of regional economic cooperation and signed the agreement to create intergovernmental organization.... SAARC. The main objectives of the South Asian Association for Regional Cooperation were the development of the South Asian region and collaboration with the international political and economic organizations to cope with the challenges of the global economic system. However, the idea of SAARC was floated by Bangladesh in 1980 while India and Pakistan were reluctant to go with such an idea because of their mutually bitter political relations. Later, a series of meetings among government officials of South Asian countries to formulate the framework and charter of the proposed regional organization (1981-84) developed a healthy environment for India-Pakistan's trade relations, consequently, Pakistan and India permitted 40 merchandises in which both countries' private sector could trade with each other (Ali, 1996).

Actually, India and Pakistan have had a closed economy for a long time. Jawahar Lal Nehru (first Indian prime minister) was declared India ...a socialist republic. "During the British Raj, the Indian public sector was responsible to produce goods for fighting men. The Indian economy was under the control of a highly developed bureaucratic system (Batool, 2018). As far as Pakistan is concerned, it adopted the policy of self-sufficiency and started the industrialization program on an immediate basis (soon after the 1948 war with India). Because India had halted all types of trade with Pakistan on the issue of 'currency depreciation' and Pakistan was starved of basic necessity products.

However, the bilateral trade between India and Pakistan remarkably increased after the creation of SAARC. The IMF and World Bank's structural adjustment programs (from the mid-1980s -mid-1990s) also contributed a lot to boost up bilateral trade volume of the two countries. These programs were initiated by the Bretton wood institutions in developing countries for economic development and poverty alleviation. They assisted developing countries to privatize public enterprises, open up their borders for trade liberalization, and convinced governments to deregulate the market and allow open competition. Especially,



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IMF bailouts tended to involve free-market reforms as a condition of receiving money (Pettinger, 2017). In the early 1990s, in all this scenario, under the directions of IMF India, and Pakistan they started to open up their borders for trade liberalization. Pakistan followed that policy in 1996 while India resisted free trade and remained a close economy till 2000. Another global development, during that period, occurred when WTO established and replaced GATT in 1994. The signatories of GATT automatically became the members of WTO, so Pakistan and India also became the member of WTO. Now, they were bound to follow WTO policies, in this context, India granted MFN status to Pakistan. But Pakistan did not reciprocate the MFN status to India due to the strong resistance of the automobile and textile sectors (PBC, 2017). The trade between the two countries, further, increased after the creation of the SAARC Preferential Trade Agreement (SAPTA) in 1995. Under that agreement 5550 tariff lines were successfully negotiated for tariff concessions (Bureau, 2013). Further, Pakistan included 600 items in the import list in July 2000 while that number increased to a 1075 tariff line by November 2006 (Ghuman & Madaan, 2006).

The trade relations between India and Pakistan derailed after the incident of the Kargil War but SAARC played a significant role to revived the political and economic relations between the two. Since 1992, after the creation of the SAARC apex body, the SAARC Chamber of Commerce and Industry (SCCI), the private sector of all south Asian countries was active to motivate their respective governments for trade liberalization in the region. The regional offices of that body were located in all SAARC member countries. The backdoor diplomacy and lobbying of CCI helped Pakistan and India to reconcile with each other at the platform of SAARC. Previously that body had played an active role in the creation of SAPTA. SCCI also worked hard to make possible the creation of the South Asian Free Trade Agreement (SAFTA) in 2004 (SAFTA, 1994). SAFTA allowed free trade in goods (cross-border movement of goods with zero tariffs) with a negative list approach. Each member country was allowed to maintain a list of such trade items that might require protection from foreign competition (Tabish & Khan, 2011).

However, the government of Pakistan successfully initiated trade dialogues with India during the Musharraf regime that continued from 2004-2007. The two countries decided to open up the sea and road routes to facilitate bilateral trade. Later, in 2008, both relaxed the Line of Control (LOC) restriction and allowed travel and trade across the LOC (PBC, 2017). So, the volume of bilateral trade remarkably increased before the formal launching of SAFTA, though trade flow was in favor of India (ICT, 2011). The Mumbai incident (a terrorist attack on the Indian parliament in 2008) halted the trade dialogue. India accused Pakistan of the attacks and suspended the dialogue till 2010. In 2011, the two governments revived the trade talk process on and the government of Pakistan announced that it would grant MFN status to India and replace the positive list with the negative list till 2012 (Pasha, 2012). Being a member of WTO, Pakistan was bound to give MFN status to India while replacing the positive list with the negative list was the

matter related to SAFTA. Actually, the Positive list approach to trade is limited scope for free trade while the negative list approach broadens the scope of free trade. The positive list approach allows trade only in enlisted items whereas the negative list approach allows trade in every tariff line except those is enlisted in the negative list.

Further, the two countries agreed to extend trade liberalization in other areas of the economy and India opened up its investment sector for Pakistani businessmen. For that purpose, visa rules were relaxed for businessmen (MOC). However, Pakistan had to take back its decision related to MFN due to multiple reasons (one of the reasons was the literal meanings that were making public opinion negative toward it). In 2013, the Government of Pakistan conducted a series of studies to analyze the India Pakistan trade feasibility and utility with the collaboration of the institute of public policy and the Pakistan Trade project. After assessing the findings and recommendations of those studies, the ministry of commerce granted MFN status to India with the name of Non-Discriminatory Market Access (NDMA) (Batool, 2018).

The trade relations between the two once again suspended from the Indian side after the Uri attack (a terrorist attack on the Indian army in Uri in occupied Kashmir) in 2016 and refused to attend the 19th SAARC summit hosted by Pakistan. Besides, India announced to suspend the MFN status to Pakistan, however, it had to take back its decision on “the pressure of business community that could lose their immediate market due to expected trade embargo from the Pakistani side in the reaction of Indian act” (Batool, 2018). In 2018, the newly elected government of Pakistan gave an offer to India for the restoration of trade dialogues for the alleviation of poverty on both sides of the border but India did not reciprocate in this regard. The trade relation between Pakistan and India could not restore due to the Indian act of suspension of article 370 of the Indian constitution that changed the Jammu and Kashmir autonomous status as a princely state. However, third-party trade and tariff-led trade is a routine matter and continued in all circumstances.

## **Conclusion**

The study concludes that economic liberalization has a positive impact on India-Pakistan trade relations. Its major contribution concerning the two countries is that it mobilized two hostile nuclear countries for trade relations through Bretton wood institutions' structural adjustment programs, WTO's trade liberalization policies, and SAARC's effort for free trade practices in South Asia under the South Asia Free Trade Agreement. The matter of fact is that only commercially beneficial borders have the potential to reduce the political tension between the two. Bilateral free trade can solve the socio-economic crises of both nations and can ease the tension on the borders. After Washington's consensus, the burden of development has been shifted from state to private sector. The state is, now, responsible to provide an environment in which ease of doing business can be best possible.

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Pakistan is currently working hard on this aspect, so, the two countries should mobilize their private sector in bilateral trade relations. Restrictions on formal trade raise the volume of informal trade and encourage smuggling that has negative socio-economic consequences (and are not in the benefits of the two countries). To avoid this situation formal trade is the best solution and the only way forward for both countries.

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