



RESEARCH PAPER

Illegal Trade Volume between India and Pakistan: Legal Options and Opportunities

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ABSTRACT

This research paper provides a critical analysis of South Asia where India and Pakistan are two major countries. However, the normal trade between the two countries was suspended for a long time. An important analysis begins with the illegal trade between Pakistan and India and outlines some legal options and legal trade opportunities. This research paper also described the status of MFN between them. This study investigates the benefits of bilateral trade between the two countries. Furthermore, bilateral trade between both countries will also result in more public revenues, since governments can earn more through custom revenues when smuggled items switch to formal trade. This paper examines the volume of illegal trade that is larger than the legal trade. In addition, it describes illegal trade routes between the two countries. The bottom line is that deeper engagement through normal bilateral trade would lead to significant welfare gains between the two countries.

KEYWORDS: Bilateral Trade, Informal Trade, MFN Status, SAARC, Trade Liberalization

Introduction

In the period following the partition of India and Pakistan until the establishment of the World Trade Organization (WTO), both countries traded in limited quantities. In 1996, India granted Pakistan the status of Most Favored Nation (MFN). However, Pakistan has continued to follow the positive list approach for imports from India. Even when the South Asian Free Trade Area (SAFTA) started in 2006, Pakistan did not provide MFN status to India. The constructive nature of the list was a clear violation of SAFTA, as it implied the discriminatory treatment of other member states. Trading under the positive list led to informal trading, especially for things that were not listed well. In 2004–05, illegal trade was estimated to be as large as legal trade (Taneja & Bimal, 2017). About 88 percent of the illegal trade is routed through third countries (mostly Dubai). Here, goods enter the Pakistani market after passing through Iran and Afghanistan, or directly to Karachi by sea. Even though the increase in the positive list from 875 items in 2000 to 1,934 in 2009 increased trade, the expansion focused on three areas: chemicals, basic metals, machinery, and electrical equipment accounting for 59 percent of the total number of items on the positive list in 2009 (Khan, Yusuf, Bokhari, & Aziz, 2005). Also, the expansion was not based on any economic strategy. In several areas, there was no expansion in the positive list, as the Protectionist lobbies with vested interests did not allow for further market access to Indian goods. A comprehensive analysis of trade data shows that the two countries are important trade partners. Pakistani exports to India are almost half of its exports to South Asia, and its imports from India account for more than 70 percent of its imports from South Asia, which in value terms are more than its imports from France, Canada, the Netherlands, Turkey, Iran and Thailand. However, trade between the two countries is lower than its potential. Trade relations between India and

Pakistan are three-dimensional, namely: “black” or illegal trade carried out by land borders; circular or “informal” trade carried out through “third” countries and then re-exported from there to Pakistan; finally, the official trade carried out through imports/exports of goods and with all recognized seaports, airports, and land customs stations. Circular trade is done by agents who are stationed in free ports such as Singapore or Dubai and is estimated at \$ 1 billion. (Pasha & Imran, 2015). Thus, the combined volumes of illegal and circular trade are much higher than the legal levels of trade. The trade exported to Pakistan from India that is ‘black’ or smuggled trade which included industrial machinery, cement, tires, chemicals, and tea. Indian illegal trades are edible oils, spices, dried fruits and pulses. In South Asia, Pakistan and India are the two largest economies but the lowest levels of trade between them. Because of border disputes and political differences. In 2007/08, legal and illegal trade between the two countries was estimated at US \$ 2.5-2.6 billion but increased US \$ 5-10 billion or two to four times its current levels. India's exports to Pakistan dropped by about 16 percent to USD 1.82 billion in 2016-17 compared to \$ 2.17 billion in 2015-16 after relations deteriorated in the aftermath of a terrorist attack in Uri and the Indian Army's surgical strikes on militant launch pads in Pakistan-occupied Kashmir in 2016 (Taneja, Mehra, Mukherjee, Bimal, & Dayal, 2015).

Despite ongoing conflicts, trade between the two countries gradually increased over the years. India's exports to Pakistan were about 6% to USD 1.92 billion in 2017-18, and then about 7% in 2018-19. Imports from Pakistan, increased by 7.5% to USD 488.56 million in 2017-18 compared to \$ 454.49 million in 2016-17. In 2019, India and Pakistan took steps to prevent trade against each other. Following the Pulwama terrorist attacks in Kashmir in February 2019 and cross-border air strikes, India withdrew from the status of the Most Favoured Nation (MFN) of Pakistan and imposed a customs duty on imports that was 200%. Later, when India abrogated Article 370 and revoked the autonomy of Jammu and Kashmir, Pakistan suspended bilateral trade (Naqvi & Schuler, 2007; Yaseen, Jathol, & Muzaffar 2016). In 2018-19, India exported cotton and organic chemicals to Pakistan. Other major items included, plastics, tanning /dyeing, and nuclear reactors, boiler machines and mechanical appliances. After the ban, imports fell sharply, while imports of cotton have also stopped. Pakistan decided to ban cotton imports as there is a shortage of raw materials for Pakistan's textile industry, which has suffered due to low domestic yields of cotton (Manzoor, Maken, Syed, & Ahmed, 2018). Over the years, India has had a trade surplus with Pakistan, India imports less and exports more. Pakistan was among India's top 50 trade partners in 2018-19 but was eliminated from the 2019-2020 list. A trade ban between the countries would affect Pakistan more because Pakistan relies on India to acquire the essential raw materials for its textile and pharmaceutical industries (SARDAR, 2014). The exact amount of illegal trade is unknown, but there are different ‘guess estimates’ of illegal trade between India and Pakistan ranging between \$ 250 million and \$ 2.0 billion yearly. Most of the trade between India and Pakistan happens through informal channels. This means that bans on trade in Jammu and Kashmir are unlikely to have a major impact (Taneja, Ray, Dayal, & Bimal, 2017).

Literature Review

In South Asia Pakistan and India are the two largest economies. Together, they make up 90 percent of the gross domestic product (GDP) and 85 percent of the population of the region. They share a border and have similar cultures.



Figure No: 1 India’s Trade with Pakistan (IN\$)

If we look at neighboring countries like India and Pakistan in terms of population or current GDP - like Malaysia and China or Brazil and Argentina-bilateral trade accounts for 2.2% and 10.2% respectively, of world trade in these countries. The case of Pakistan and India is very different. In 2007/8, the share of total trade between Pakistan and India was less than 0.5 percent with the rest of the world. According to, Taneja's the value of the illegal trade between India and Pakistan is estimated at \$ 2 billion, half of which is traded through third countries (technically official trade) such as Dubai, the CIS countries and Afghanistan while the other half cross-border trade is illegal (Muzaffar, Yaseen, & Afzal, 2021).

Table 1
Trade between India and Pakistan (All figures in \$ Million)

Year	Export	Import	Total trade
2017-2018	1,924.28	488.56	2,412.83
2018-2019	2,066.56	494.87	2,561.44
2019-2020	816.62	13.97	830.58
2020-2021	326.87	2.39	329.26
2021-2022	513.82	2.54	516.36

Source: Indianexpress.com

Mukherjee points out that the illegal exports of these two countries include machinery, cement, tyres, tea, medicines, alcohol and chemical products, etc. Illegal imports from Pakistan include food items, synthetic fibers and other chemical products (Choudhri, Marasco, & Nabi, 2017). FICCI 2001, indicates that commodities are being smuggled into Pakistan through third countries. India and Pakistan have the largest economic size in South Asia, with a fairly lower level of bilateral trade, accounting for about 3 percent of total trade. The volume of exchange as of 2010, stood at US \$ 2.6bn - much lower than the estimated trade Potential of US \$ 20bn. Despite numerous attempts to promote trade between India and Pakistan, there has been no significant progress (Batool and Ahmed, 2014). The Southeast Asian countries account for 8.2 percent of the world's total exports and the share of South Asian countries (Pakistan and India) is only 0.5 percent (Rashid & Hilali, 2020).The World Bank estimates that annual trade between India and Pakistan could grow to as much as \$ 9 billion if the barriers are lifted. Most of the current trade of illicit products passes through Dubai, where it is repackaged and smuggled into both countries, meaning higher prices and lower taxes (Adnan & Fatima, 2020).The Indian government stopped cross-Loc trade in April 2019, when it received reports that cross-Loc trade routes were being misused by Pakistani-based factors for funneling illegal weapons and drugs. According to a study by ICRIER, the informal trade between the two countries in 2012-13 had almost doubled the number of legal trades, and much of this was transferred through a third country. Pursuing this further, illegal

trade between the two countries in 2018-19 was as big as or bigger than legal trade, the study estimates (Murshed, Chadni, & Ferdaus, 2020).

Illegal Trade

Illegal trade usually occurs for the following reasons: I) restrictions on imports for various reasons such as health problems, religious beliefs, or economic reasons; (ii) high tariff barriers or transportation costs that make it cost-effective to smuggle the goods into the country; and (iii) the imposition of non-tariff barriers such as quantitative restrictions (iv) weaknesses in the 'rules of origin' resulting in trade routed through a third country (Kumar, 2020). The smugglers/traders in particular engage in illegal trade between Pakistan and India through the exchange of goods at the Indo-Pakistan border. Illegal trade also takes place in Afghanistan where goods are officially exported from India to Afghanistan and later smuggled into Pakistan via Peshawar, near the Pakistan-Afghan border. Indian goods smuggled into Pakistan include cosmetics, alcoholic beverages, stainless steel utensils, ayurvedic medicines (30 percent cheaper in India), videotapes, cassettes, nuts, tea and coffee, live animals and spices (Shah, 2021). The Sustainable Policy and Development Institute (SPDI), Islamabad, estimates illegal trade between Pakistan and India at \$ 545 million in 2005. The total amount of illegal exports from Pakistan to India does not exceed \$ 10.5 million, which mainly includes textiles (cloth, bed sheets, blankets and prayer mats comprise 90 percent of illegal agricultural products. Illegal imports from India amounted to \$ 534.5 million in 2005. The extent of informal trade is often used as an indicator of the latent potential that thrives between the two countries. Illegal traders in both countries have developed effective ways of information flow, risk sharing and risk mitigation

Material and Methods

This research study was conducted with secondary data. In addition, this study is based on qualitative research. Such as books, various articles, magazines, newspapers, journals, blogs, online books, websites and research articles published by various scholars and researchers.

Result and Discussion

The value of illegal trade between Pakistan and India is estimated at USD 4.7 billion in FY13. India's exports to Pakistan were approximately USD 3.99 billion and imports from Pakistan were USD 0.72 billion.

Major Routes and Modalities of Illegal Trade

Most of the India-Pakistan illegal trade flows through third countries, especially Dubai. One can elaborate on the seven routes through which illegal trade between India and Pakistan takes place:

1. India-Dubai-Pakistan
2. India-Dubai-Iran (Bandar Abbas) -Afghanistan-Pakistan
3. India-Dubai- Pakistan (Karachi) - Afghanistan-Pakistan (sea and land route)
4. India-Pakistan (Karachi) -Afghanistan-Pakistan (sea and land route)
5. India- Afghanistan-Pakistan (air route)
6. Delhi-Amritsar-Lahore (bus/train)
7. Cross LoC Trade Routes (Uri-Salamabad and Poonch-Rawalkote)

The first route namely India-Dubai-Pakistan is a major trade route. Trade is recorded between India and the UAE and between Pakistan and the UAE but is not recorded between India and Pakistan. In Dubai, goods are stamped with a traditional

country outside of India. There are some cases where the trading method is done “by switch bill of lading”. In such a system, ships containing goods that are not allowed to be imported into Pakistan, are supposed to travel to Karachi through a third port (e.g. Dubai). However, ships travel directly from an Indian port to Karachi (Taneja et al., 2015). The second, third, and fourth routes are Afghan transit routes, where goods are routed to Afghanistan (either directly or by Iran or Pakistan). In Route 2, goods are officially moving from India to Dubai. Containers were shipped from Dubai and Dubai to Bandar Abbas (Iran) from where goods are transported overland by trucks to Afghanistan and finally to Pakistan. In Route 3, products move by sea from an Indian port to Karachi port in Pakistan via Dubai and then move to Afghanistan by road and further on enter into Pakistan illegally (Ahmed & Batool, 2017). In Route 4, goods move by sea from the port of India to the port of Karachi in Pakistan and then move to Afghanistan by road and further on enter into Pakistan illegally. In both routes 3 and 4, goods sometimes deviate from the path. On route 5, the goods are directed to Afghanistan but return to Pakistan informally via the land route.

During a visit to the survey team (February 2013) the kunoos and plums were being exchanged through the Kashmir-Chakoti border. The volume of informal exchanges was around 20-30 trucks per week and the exchange rate reached PKR 540 million. The Informal exchange includes high-quality artificial jewelry, bridal sets, bracelets and lockets. Tobacco items are also informally traded. Spices and herbs illegally exchanged trade include Black tea, Cardamom, Cinnamon, and Jaiphal. India-Afghanistan (Kandhar) -Chamman-Karachi India — Afghanistan (Kabul) —Peshawar (Torkhum / Bara) —Lahore and Rawalpindi. Kochhar and Ghani emphasized that promoting trade will lead to benefits not only in India and Pakistan but also in South Asia as a whole. South Asia is the least integrated region of the world, and is plagued by poor electricity grids, railways and roads; damaging trade costs, as illustrated by the long waiting periods for trucks at border crossings (lines at the India-Bangladesh border can last up to 99 hours). However, their essay, argues that promoting better trade facilitation would increase the flow of commerce so that regional growth could increase by 1 to 2 percent. In the post-Cold War era, nations have shifted the emphasis in their domestic and foreign policies from Politics to economics (Qamar, 2005).

This is evident from the growth of regional economic blocs such as the Association of South-East Asian Nations (ASEAN), and the European Union (EU). Although these groups had their origins before 1991, they gained great prominence in the post-Cold War era. In the Indo-Pakistani context, the role of the South Asian Association for Regional Cooperation (SAARC) also raised awareness of political leadership in the subcontinent on the need to increase intra-regional cooperation and trade. In addition, the enhancement of India-Pakistan economic relations is essential to increase the level of trade flows between the South Asian regions as a whole. India and Pakistan are both members of the South Asian Association for Regional Cooperation (SAARC) organization. And both have signed an agreement to form a concessionary trade regime, the South Asian Free Trade Area (SAFTA). However, SAFTA has failed to be implemented due to political problems. Until recently, India had bypassed the South Asia region and had focused on signing a series of bilateral trade agreements with regional organizations (Muzaffar, Jathol, & Yaseen, 2017)



Figure 2 Major Informal Trading Routs between India and Pakistan Source by Google

Conclusion

In conclusion, since their creation in 1947, the relations between the two countries have been strained due to the Kashmir issue, having fought three wars and that's why normal trade between the two countries was suspended for a long time. It is expected that the restoration and expansion of trade relations will create an environment of stable peace between India and Pakistan. In addition, the enhancement of India-Pakistan economic relations is essential to increase the level of trade flows between South Asian as a whole. Normal trade relations between the two countries can only be established after a lasting solution to the Kashmir dispute. Bilateral trade through land route is beneficial to both countries, as the additional cost of transportation on trade via sea route is estimated at \$ 3 billion. In the current era, both countries have attempted to adopt more pragmatic policies towards each other and intra-regional trade is an effective way to end mistrust and deep-rooted suspicions over the past fifty years. Importantly, economic relations in India-Pakistan will initiate intra-regional trade with SAARC and thus, transform the regional states into a powerful economic bloc.

Recommendations

In South Asia, despite entering into trade agreements between the two countries and all its regional neighbors (excluding Pakistan) through arrangements outside the SAARC framework, India has failed to open its internal markets by maintaining high non-tariffs barriers. As a result, no meaningful trade between the regions is taking place, which gives a deep sense of frustration to the region about India, especially since very few efforts have been made to address the region's grievances. Excessive trade profits favored India consistently, or smaller countries should have benefited greatly. On the other hand, Pakistan has a fear that if too much progress is made in trade, other unresolved political issues, especially the Kashmir conflict, could be put on the back burner. China, one of Pakistan's closest allies and perhaps a role model for economic development, is heavily focused on trade with its neighbors despite unresolved political issues. China / Taiwan and China / India are two key examples where trade and investment have remained intact.

India enjoys a trade surplus with Pakistan. At least in the short term, India should increase exports to Pakistan (such as machinery and technology) which are currently

imported at higher prices from other countries but hold back on exports that could hurt Pakistan's small and medium businesses.

India and Pakistan limit each other's ability to use the other's territory to reach third countries. India did not allow Pakistan to access Nepal, Bangladesh, and Bhutan through its territory, and Pakistan did not grant transit rights to India to access export markets in Afghanistan. Such transit restrictions (and related concerns regarding strict visa rules) should be placed on the normalization agenda. This is important if the full benefits of region-wide trade (from China to Iran) are to be enjoyed.

Swift and cost-efficient interstate (and intrastate) movement of goods will entail removing restrictions on the type and size of trucks and train cars; ameliorating the quality of the roads and railways used for trade in both countries; and improving cross-border infrastructure. The trade normalization process is generally expected to expose major trade opportunities in India and Pakistan. For this trade to succeed, however, a few steps must be taken by both countries. Other steps that need to be taken to increase trade on the road route include removing restrictions on truck type and allowing Indian and Pakistani trucks to move freely in each other's territory so that there is no need for transshipment at the border. Most argue that trade potential between the two countries would be much higher than the current level if the large volume of informal and/or third-country trade were to be counted. The bottom line is that deeper engagement through normal bilateral trade would lead to significant welfare gains between the two countries.

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