

REGIONAL TRADE BETWEEN INDIA AND PAKISTAN: PROSPECT OF MOST FAVOURITE NATION (MFN)



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ABSTRACT

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The globalization especially economic globalization let the process more progressive and with the advancements in the iteration of innovation and inventions in technologies related to trade, marine, communication, logistics, production and management etc, have substantially reshaped the pace of trade and exchange. In this paper the impact of political decision on regional trade between India and Pakistan has been studied, from the prospect of Most Favorite Nation (MFN). Where the time period was 1951 to 2011, using STATA. Study is based on Pre and Post MFN status. As the study shows that there is a substantial evidence that Indian decision of declaring Pakistan as MFN has shifted the dimension of trade in favor of India. Where the process of globalization and increasing consumerism in Pakistan has let the Trend to be significant in case of Indian exports to Pakistan. Whereas, Pakistan hasn't gain much after this decision relatively. Moreover, Indian exports to Pakistan increase when Pakistan economy shows improvement. On the other hand, Pakistan export to India are indifferent of Indian economic situation. Status of government in Pakistan has insignificant impact on mutual trade.

Contribution/ Originality: This paper contributes to the contemporary trade economics while incorporating the role of MFN into the bilateral trade balance, with a comparative analysis of pre and post MFN scenarios of trade dimensions between India and Pakistan.

1. INTRODUCTION

Regional Trade Agreements (RTAs) reported to World Trade Organization (WTO) has increased significantly since 1990. Trade within regions remains strong in North America, Europe and Asia. Europe has the highest level of intraregional trade, with 71 percent of its exports remaining within Europe in 2011. A total of 53 per cent of Asian trade is exported to Asian countries, while nearly 48 per cent of North America's exports are to members of the North American Free Trade Agreement (NAFTA). In South and Central America, 27 percent of exports went to other countries in the region in 2011. In the Commonwealth of Independent States (CIS), Africa and the Middle East, total trade was 20 per cent, 13 per cent and 9 per cent respectively. Africa's main destination market for export is the European Union, followed by Asia and North America. A little over half of CIS exports go to Europe and the Middle East's main market is still Asia. Less than a quarter of South and Central America's total exports go

to North America and 22 per cent goes to Asia. World merchandise exports increased by 5 per cent in volume terms in 2011. World's gross domestic product (GDP) expanded by 2.4 per cent. Since 2005, world merchandise trade has grown by 3.7 per cent annually while GDP has risen by 2.3 per cent. Some of the growth in merchandise trade is due to trade in intermediate products that crisscross national borders before being processed into final products

India and Pakistan, who were favorable for trade even after the partition in 1947. Both are traditional markets for each other, who have engaged themselves into trade business over the years. With largest border and strong economies of the region if India and Pakistan trade openly with one another they can play a vital role not only for their own economies but the South Asian¹ region.

Countries of South Asia in 1985 entered into an economic corporation blocks as South Asian Association for Regional Corporation (SAARC). Purely based on economic corporation we have seen little progress in this block where it has failed to achieve its prime objectives, political tensions between India and Pakistan are one of the major reasons other than, protection policies adopted by the countries, and Indian strict trade policies in order to maintain its monopoly in the region.

Practical implication of SAARC objectives is beneficial for all member countries as well as the developing countries along with Middle East, Russia, and China. Member countries will get both financial and welfare gains as we see in case of other regional blocks like ASEAN. They can also have access to cheap and high quality products and the bigger market share within the region that can help them in achieving their and the cooperation goals (DeRosa and Govindan, 1997).

Countries are combining together to form Regional Trade Agreements (RTA's) where 193 RTA's are registered and functioning under World Trade Organization (WTO)². More and more countries are entering into regional blocks in order to get the desired benefits. Last decade has witnessed the increasing trade agreements with bilateral or multilateral registered at WTO's forum. The correlational analysis of different level has shown that RTAs in the reign of global period have been promising the development of the parties involved. If SAARC countries cooperate in doing trade with each other they can enjoy many benefits; both financially and economically. Hence, the objective of this study is to investigate the impact of political decision on regional trade between India and Pakistan, from the prospect of Most Favorite Nation (MFN) from the time period 1951 to 2011.

1.1. Different Trading Routes

Pakistan is facing serious economic problems and it is very important for its survival to make good relations with its counterpart India. In early days both countries were highly dependent on each other in trade. To reduce this dependency on each other both countries especially India adopted inward economic policies. In the light of these policies efforts were made to stop trade with Pakistan and local industries were promoted by giving incentives to them.

On the other hand, India and Pakistan pursued for other international markets, these markets were remote in nature and didn't coincide with them traditionally. Both countries had to face traveling and transshipment cost while trading with their new business partners. Mehta (2012) describes that if Pakistan intends to divert its imports in more than few items towards India it can save U.S. \$ 400 million to U.S. \$ 900 million on its import invoice. Similar results and arguments have been drawn in other studies like Qamar (2005) and Ghuman and Madaan (2006).

Being neighboring countries both India and Pakistan are well connected through land, air and sea. Trade between India and Pakistan can be separated into three categories; official trade, unofficial or illegal trade and

¹Afghanistan was included in this block under the umbrella of South Asian Free Trade Agreement (SAFTA) in March 2008 Noorani (2012).

²http://www.ehow.com/facts_6850611_definition-regional-trade-agreements.html

circular trade. In case of India, these provisions can be high duties on several items especially agriculture base products, whereas, in Pakistan it could be the case that the items that are brought illegally are not on the potential list. Some other reasons are; high tariffs, and non-tariffs barriers, economic reasons, transportations cost, and indirect taxes. Potential list includes all those items, which are authorized under the Pakistani government to be imported from India or in which business community on either side of the boarder could operate. It was July 1982, when Pakistan gave permission to private sector in India and Pakistan to conduct trade in 40 products. This list was further expanded to 571 objects in 1989, then to 600 products in 2000, and 1075 in 2006 (Ghuman and Madaan, 2006).

Illegal trade between the two countries takes place through Indo-Pak border, where people exchange goods and hand baggage. These are also smuggled directly into one another territory by exploiting people or government officials. Most of the time illegal products of Indian origin land up into Pakistan via Afghan-Pakistan border. From Pakistan side illegal exports mostly includes agriculture related products that are approximately 90 percent with a combine worth of U.S. \$ 534.5 million. Whereas, its imports have combine value of 80 percent that includes cloths, tires, pharmaceuticals, textiles machinery, cosmetics, livestock and medicines³.

There is no exact evidence of their informal trade and different authors have different supposition. From the study of Taneja (2006) informal trade for India and Pakistan accounts for \$ 3billion of which Pakistan's share is 68 percent. The author further said that these smuggled Indian goods into Pakistan make worth of \$ 250 million. Wajid (2003) has identified that despite the MFN status from India both countries are into informal trade business. According to author this trade is done either illegally or through third country also called circular trade where Pakistan faces \$ 500 million losses in a year as custom duty.

The two countries trade in banned products that each country has enforced especially by Pakistan. In this process they are engaged in circular trade where they import from other ports like Dubai, Hong Kong and Singapore and through Afghanistan. This process adds additional costs for these countries in their earnings and if they can work on their relations they are surely to get much benefit (Ghuman and Madaan, 2006).

1.2. South Asian Free Trade Area (SAFTA)

The South Asian Free Trade Area (SAFTA) is an agreement reached on 6 January 2004 at the 12th SAARC summit in Islamabad, Pakistan. It created a free trade area of 1.6 billion people. The seven foreign ministers of the region signed a framework agreement on SAFTA to reduce customs duties of all traded goods to zero by the year 2016.

The SAFTA agreement came into force on January 2006 and is operational following the ratification of the agreement by the seven governments. SAFTA requires the developing countries in South Asia (India, Pakistan and Sri Lanka) to bring their duties down to 20 percent in the first phase of the two-year period ending in 2007. In the final five-year phase ending 2012, the 20 percent duty will be reduced to zero in a series of annual cuts. The least developed nations in South Asia (Nepal, Bhutan, Bangladesh, Afghanistan and Maldives) have an additional three years to reduce tariffs to zero.

Studies have shown great return and growth for regional countries engaged in mutual trade. But the picture is other way around for SAARC countries and from the study of Tabish and Khan (2011) we notice that intra-regional trade for this regional block accounts for 5%, which is very low as compare to other regions that is high as shown in other studies.⁴ Hussain (2011) has made a very valuable contrast of trade between different regions. The writer took five different regions and analyzed the trade between them in percentage of total exports. From the Table: 1, below we see that there is rapid increase in percentage of trade between other regional groups, whereas this percentage of

³ http://www.sbp.org.pk/publications/pak-india-trade/Chap_2.pdf

Ghuman and Madaan (2006).

trade for SAARC shows less growth over the years. It was only in the year 1995 when India granted Most Favored Nation (MFN) status to Pakistan after which trade between the two countries increased rapidly; for all other economic years we see little progress in trade of this region.

Table-1. Trade within Regional Blocks, (Percentage % of total Exports)

	1990	1995	2000	2005	2009
SAARC	3.5	4.5	4.6	6.6	5.4
ASEAN	18.9	24.4	23	25.3	24.5
EAC	17.7	19.5	22.6	18	18.9
CACM	15.3	21.8	19.6	23.2	22.3
CIS	---	28.4	19.8	17.7	14.8

Source: Hussain (2011)

India and Pakistan are of great importance in SAARC. Together they make 87 per cent of the total population and 90.7 percent of the total SAARC area⁵. Their economic cooperation can change not only their but overall picture of the region. Unfortunately, this cooperation is very less, refraining them from getting actual growth that they can get while trading openly with one another. The main reasons for their non-cooperative trade regimes are covered later in the study.

1.3. Trade Dimensions

Trade between the two countries was very different in the beginning as compare to what we see at present. According to some studies in the beginning total trade for Pakistan with India was 70 percent, whereas Indian share of exports were 63 percent. Similar results have been deduced in other studies where trade between the two countries showed positive results in first few years⁶. With up's and down's in their political relations, trade was mostly effected. There are many reasons due to which bilateral trade relations could not strengthen like political tensions, import protection policies, tariffs and non-tariffs issues, visa issuing, issue of Jammu and Kashmir and granting MFN status to India.

The economic relationships in the early few years have been very great and both the countries did most of the trade with one another. Trade between the two countries was mostly in favor of Pakistan and it holds major share for bilateral relationship between these trade allies, Noorani (2012). After independence Pakistan's three fifth total exports were going toward India and one third of its imports were coming back, Naqvi (2009).

When India devalued its currency in 1949 and Pakistan did not corporate and appreciated its currency. As a result import restriction bilateral trade relations started to go down and this process moved faster in the presence of a catalyst that in this case was wars and terrorist attacks as shown in Figure: 2. After 1948 war it had little impact on the trade, yet the trade did not stop and the balance of trade was in favor of Pakistan, which in 1951 exported goods of worth U.S. \$ 113 million to India and imported U.S. \$ 0.08 million goods from India.

Overall the two countries fought four wars and faced terrorist attacks in each country due to which bilateral trade relations were mostly effected. These wars were fought in 1948, 1965, 1971, and 1999. Beside this Indian parliament building was attacked in December 2001, which resulted in tense political condition from 2001 to 2003, and on November 26, 2008 we saw Mumbai terrorist attacks in India, which further hindered the trade relations, Anonymous (n.d).⁷

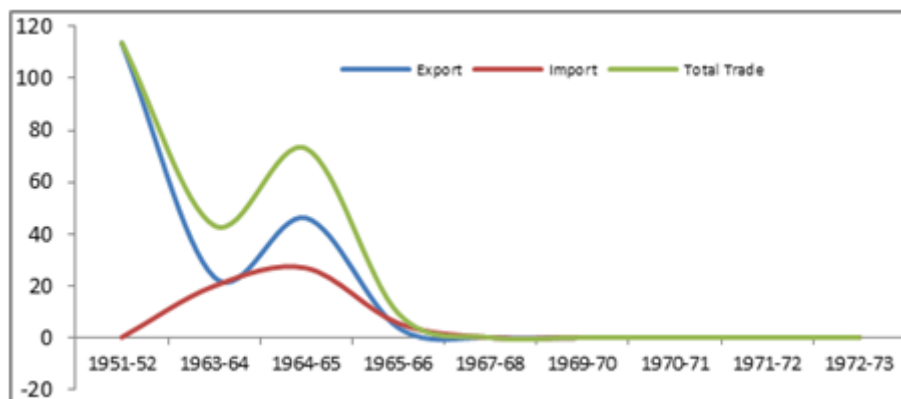
January 23, 1975, both countries signed the bilateral trade agreement due to which their relations were again on track and trade only took place at government level. This was the only trade agreement between the two

⁵Ibid.

Burki, Khan and Hussain (2006).

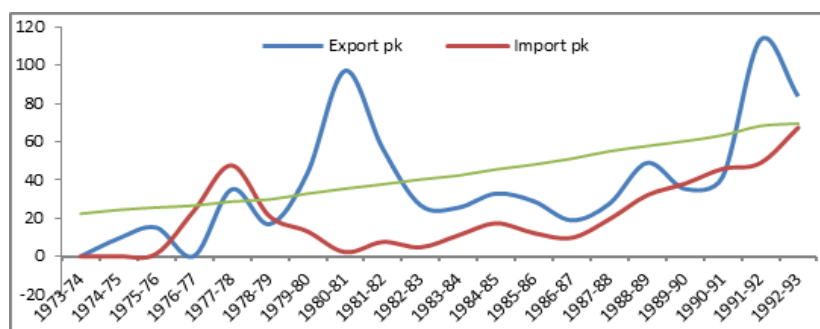
⁷ http://www.sbp.org.pk/publications/pak-india-trade/Chap_2.pdf

countries with a combine life span of three years. This agreement came to an end on January 22, 1978, and after that to today trade is



Graph-1. Imports and Exports of Pakistan with India (1951-1973)

Without any agreement. During this period trade was mostly in favor of India, when Pakistan imports increased from \$ 1.28 million to \$ 47.57 million, whereas its exports to India during the same period of time were very low and the total trade rose from \$ 16.37 million in 1975-76 to \$ 82.62 million in 1977-78.

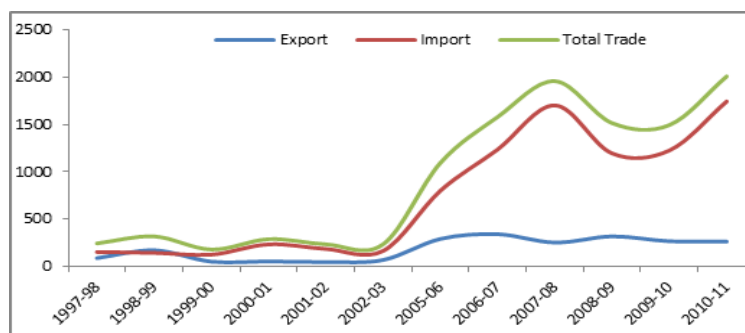


Graph-2. Imports and Exports (mil \$) of Pakistan-India (1951-73) GDP Pak in Billion \$.

For the coming years trade was mostly in favor of Pakistan, which was between U.S. \$ 30 million to U.S. \$ 80 million, which shifted to Indian side after 1995 when India declared MFN status to Pakistan. The coming year imports from India grew for Pakistan whereas its exports remain still, Anonymous (n.d).⁸

Peace prevailed for next few years, could not last for long as a result of Kargil war in the year 1999. This resulted in trade drop from \$ 319.5 million to \$ 181.02 million. This gap further extended after terrorists' attack on Indian parliament building in 2001 and total trade for the year 2001-02, and 2002-03 was \$ 236.3 million and \$ 237.2 million respectively. Similar results were seen after Mumbai terrorist attack in 2008 and we again saw descending trend in trade and it reached from \$ 1,514.20 million to 2008-09 \$ 1493.8 million in 2009-10.

⁸ http://www.sbp.org.pk/publications/pak-india-trade/chap_3.pdf



Graph-3. Imports and Exports (mil USD) of Pakistan with India. (1997-2011)

Since, 1996, total trade depends mostly on Indian Exports to Pakistan. As we can see in the graph-3 that total trade volume closely follows the exports of India to Pakistan, whereas, the Indian exports from Pakistan are steady and very low comparatively. Although, globalization has played its significant role yet Indian trade dimensions with Pakistan took a great turn right after 1994-95.

1.4. Potential Areas for Bilateral Trade Relations

India and Pakistan need to cooperate with each other and find ways to enhance their one on one trade relations. Pakistan with 46 joint investment agreements does not include India is of serious concerns. There is great possibility for these countries to work together in different areas where they can not only use each other expertise but can also save larger portion of their expenditures. The areas where they can work together are Modern Food Machinery Design, Design and Development Centers in each country, Fabrication Workshops and Consultancy Firms, Information Technology (IT), Fish Processing, Drugs and Pharmaceuticals (DAP), Agro Chemicals, Chemicals, Automobile Ancillary and Energy Sector. In the light of energy crisis in Pakistan there is greater window of opportunity to work for electricity production with coal, and wind energy by utilizing Indian expertise knowing that it is at number two spot in making energy with wind having installed capacity of 900 MW. Beside these the two countries can work together in Water Management and Power Projects, and importing gas from third country to meet their energy demands, where Pakistan can play an important role by providing transit route to India in order to get access to these untapped markets which include Iran and Turkmenistan⁹.

According to Mamoon *et al.* (2011) there are many possible areas in which India and Pakistan can work together. India can operate in the field of Tea, Spices, Auto Parts, Consumer and Light Energy Goods, Tires and Transport Equipment, Entertainment, Healthcare, IT and Pharmaceuticals. Whereas Pakistan can operate in Fresh Dry Fruits, Sugar, Raw Cotton, Gems, Fish, Marble and Onyx, Power and Textiles. In a study by Gul (2009) the possible areas to cooperate for both countries consist of Agriculture Products, Tea, Auto Spare Parts, Minerals, Chemicals, Pharmaceuticals, Leather, Textile, Telecom, Iron Ore, Energy Resources, Electricity using Wind and Coal. On the other hand, there is potential opportunity for private sector to work in Health, Entertainment, Services, IT and Tourism. Both India and Pakistan are dependent on textile products for their earning. Its share for India and Pakistan is 18.8 percent and 65.6 percent in that order. Both countries do not trade in agriculture products where overall products that both countries sell are 176 in which India has edge in 48 objects whereas Pakistan is far ahead with 128 textile goods. Which demand for mutual cooperation in this sector along with other areas like Chemicals and Pharmaceuticals, Iron and Steel, Automobiles, and IT (Hussain, 2011). In a study done by Qamar (2005) describe greater opportunity for both countries to work together and identified some of the potential elements and said that in this regard Pakistan is likely to get advantage because of cut in transportation costs.

⁹Source: http://www.sbp.org.pk/publications/pak-india-trade/chap_3.pdf

1.5. MFN, Pakistan and its Advantages

India declared Pakistan MFN in 1995, where Pakistan is yet to replay with similar action. There are some false believes associated with MFN that are acting as socio political constraint for Pakistan in declaring India MFN, and these are as following.

- i. Granting MFN to India means declaring them as favorite nation;
- ii. India has applied tariffs and non-tariffs barriers for Pakistani products which does not give us a free hand to trade openly with India;
- iii. Some business circles in Pakistan are worried that Indian goods will clean sweep Pakistani market;
- iv. Issue of Jammu and Kashmir is associated with MFN, where Pakistan is demanding to resolve this issue on priority basis;

If we take first point it is to clear that MFN is a term used in international economics where it stands for favored nation in terms of doing business trade and smooth transactions. Whereas applied tariffs and non-tariffs by Indian are linked with status of MFN where India is of this opinion that Pakistan should first declare MFN only then India will reciprocate with the issue of these barriers, which implies that once Pakistan declares MFN status to India it can demand relaxation on these terms, which one way or the other could be a liability at Indian part. In third case Pakistani business community should not be afraid of Indian products because WTO have given this permission to its signatories that where they feel that their industry is threatened with foreign products they can take preventive measures, which is a common practice around the globe. Once all these issues are resolved and peace will motivate both countries to take serious steps when it comes to Jammu and Kashmir.

After declaring MFN to India, Pakistan could have many advantages;

- i. Illegal products will come into Pakistan through proper channel and will earn Pakistan huge revenues in foreign exchange;
- ii. Transportation and transshipment costs will reduce that it has to bear in circular trade;
- iii. Once India will join IPI or TAPI pipeline project it will earn additional benefits in term of transit fees for Pakistan;
- iv. Pakistani products will have access to bigger market likewise they will also have access to new technology as India is more advanced than Pakistan;
- v. There will be healthy competition in Pakistani market whose eventual profit will go to end consumer.

1.6. Trade Barriers

1.6.1. Non-Tariff Barriers

According to WTO's definition, non-tariff barriers include all measures, other than tariff, that are used to protect domestic industry of a country. The perception in Pakistan is that India operates a generally restrictive trade regime in the form of a wide range of NTBs, some of which are applied more strictly on Pakistani consignments. The following sections list the two countries' NTBs.

1.6.2. NTBs in India

India operates the following key NTBs.

- Sanitary and phytosanitary (SPS) measures are harmonized with international standards and cover mostly food items.
- The import licensing and permit regimes are complex, varying according to product or user.
- There are a large number of notifications specifying mainly sampling and testing procedures as well as labeling and packaging requirements for food products, pharmaceuticals, textiles, etc.
- Quarantine is imposed on animals and plants.

- Some goods can only be imported through specified ports and/or by particular agencies.
- Pre-shipment inspection is mandatory for some goods such as metal scrap, textiles, etc.
- India actively uses antidumping duties and countervailing measures.

1.6.3. NTBs in Pakistan

- Compared to those listed above, Pakistan operates fewer, less rigorous NTBs, listed below.
- Pakistan's main trade policy instrument is the tariff regime (including SROs) rather than NTBs.
- Pakistan's SPS legislation is outdated and not effectively applied.
- Imports of products such as pharmaceuticals, agricultural products, and engineering goods require clearance by the relevant ministry/agency.
- Import restrictions are applied for health, safety, security, religious, and environmental reasons.
- State trading agencies (such as the TCP) play a dominant role in the import of agricultural inputs and products.
- Pakistan seldom resorts to antidumping and countervailing measures (Imran, 2012).

1.7. Tariff Barriers

One of the tariff barriers between both the countries is custom procedures. Custom clearance, rules of origin certification, border management policies and multiple border regulatory agencies impeded trade facilitation and hinder the full trade potential to be utilized. Inadequate land transport route is another barrier which if addressed can bring huge benefits to Pakistan. India no longer allows trade from the rail route, so land route is used for the trade purposes. Mostly, the land route used for trade is wagah –attari border, which also faces severe restrictions and only limited number of items are allowed to pass. This is one of the reasons why Pakistan mostly relies on third country trade with India, which increases the cost of transportation threefold. Quota and tariffs are also the bottlenecks on which the balance between formal and informal trade is dependent (Batool, 2013).

1.8. Financial Barriers

According to some firms some Indian banks do not recognize "Letter of credit" (L/C) from all Pakistani banks and confirmation of L/Cs can take up to a month. Sometimes payments are delayed as the banks point out discrepancies in the L/Cs. The survey in India and in Pakistan revealed that sometimes there was default in payment. Traders complained that there was no formal mechanism for trade dispute settlement. Currently Indian banks are not allowed to have branches in Pakistan. Similarly, Pakistani banks are not allowed to operate in India. This is a major non-tariff barrier for bilateral trade between the two countries. Indian banks operate in all SAARC Member countries except in Pakistan (Taneja, 2007).

2. LITERATURE REVIEW

Despite the volatile relationship, trade has played important role for economic growth of India and Pakistan, after partition and pre 1995 era, trade balance was in favor of Pakistan, Qamar (2005); Burki *et al.* (2006). An integrated, mutually agreed low tariffs and open trade can expand equal to ten times from the present state of \$ 613 between these two countries, Taneja (2006). As, Sehgal (2009) suggests that Pakistan can exploit the bigger market of India, whereas, both countries can have a substantial cut in their cost of transportation and transshipment while expanding trade. Reduction in Political tensions would eventually benefit both countries like Brazil and Argentina who share border with each other their mutual trade accounts for 10.2%, Naqvi (2009).

However, to expend their outreach to third markets by both India and Pakistan, after partition was a politically motivated decision to reduce dependency on each other, Panagariya (n.d) Restricting Jute import from West-Pakistan was one move to this context yet to promote local industry, Baysan *et al.* (2006). On the other hand,

military actions, battles and wars along with few terrorist attacks had been great hurdles in the trade progress between these two nations, despite several rounds of trade negotiations, Mamoon and Murshed (2010). Moreover, Ghuman and Madaan (2006) found substantial evidence of negative impact of wars and political tensions on trade by studying pre and post tension eras.

South Asia particularly India and Pakistan has lots of potential in trade and business yet they are not getting the desired results because of no equal opportunity for each other. Had there been equal opportunities for each other these countries would have get many benefits¹⁰.

In year 1995 there was a dramatic change occurred, when India acknowledged Pakistan as Most Favorite Nation (MFN) in compliance with World Trade Organization's (WTO) main beliefs. Since then India gained many trade benefits plus each year its trade with Pakistan grew stronger and the margin of share was on Indian side, Qamar (2005). As, U.S.A in 1994, despite their political tension declared Vietnam MFN, result; despite the smaller size of Vietnam it got enormous benefits in terms of exports where its exports were increased to double from 1996 where it was \$338 million to \$ 768 million. Countries where they have MFN agreement they enjoy the settlement of minimum tariff rates. These tariffs are applied on the mentioned items of imports and exports by both the countries. Countries that do not have such status with one another compare to those who have bear high tariffs while doing trade with one another, Fukase and Martin (1999).

In an international trade MFN is an expression that is used in terms of providing low barriers in trade, tariffs, and other concessions but most of the time it is used and taken as different. In case of MFN we make no discrimination rather it means equal. The writer further said that when U.S. granted MFN to China it was not welcomed, so they changed its name to Normal Trade Relations (NTR) in the year 1998 by making changes in their legislation, Pregelj (2005).

These tariffs are applied both on products and services. These products are from raw material to finished products which are passed through several processes after which it is used.¹¹Countries that are highly dependent on its raw products face serious consequences. Angola for example is raw cotton exporting country from which it earns little share in its GDP, Yeats (1994).

Keeping in mind MFN we come to know that it has many paybacks when it comes to trade between any two countries. Since, MFN announcement was made for Pakistan by India, it gained profit and for the seven years' trade surplus was always on its side. It was only in the year 1998-1999 when balance of trade again shifted towards Pakistan because during this time India imported more sugar.

We come to know that since India declared Pakistan MFN, trade surplus was on its side. There is special reason to that because during this period Pakistan increased the list of its permissible items to 600. Similarly, more items were added in the year 2003 and 2004 by Pakistani side i.e. 78 and 72 respectively (Taneja, 2006; Abidin *et al.*, 2016; Azam *et al.*, 2016).

Pakistan can have significant benefits by granting MFN to India and for these benefits it has to transfer its import and export products in the region especially towards India where it can have larger market access which is also sign of growth for the country's growth itself (Qamar, 2005).

India has huge interests in Afghanistan and Central Asian countries. In order to reach these countries Pakistan can work as a transit route. The writer supports his point by saying that India is fifth largest investor and trade partner of Afghanistan and lots of trade between the two countries can takes place from other channels. In such

¹⁰There is no harmony in South Asia due to which trade, traffic, and transport are badly hurt. If they are allowed to move freely the region is likely to get U.S. \$ 15 billion in five years as compare to U.S. \$ 5 billion from present state.

¹¹<http://www.investopedia.com/terms/r/rawmaterials.asp#axzz1wpOE2ex7>

situations if Pakistan provide transit route for its trade to pass through Pakistan that means we can get more profit for the country (Rana, 2011; Abidin *et al.*, 2016; Azam *et al.*, 2016).

India is engaged in different projects related to roads, buildings and other infrastructure in Afghanistan and it can be very beneficial for Pakistan to give a transit route to both countries. He further says that Afghanistan is a land-lock country and if Pakistan builds more shipping ports and open more transit routes it will get much profit (Basar, 2012). Moreover, the geo economic and strategic importance of Pakistan towards energy trade and transits to Indian is better for long run sustained economic growth of both countries (Haseeb *et al.*, 2014).

For the very same reason governments of both India and Pakistan took some serious steps to break the deadlock for trade and benefits of each other. In this process trade routes have been opened, communications are ongoing, old contracts are been restored plus MFN is in debate (Manjunath *et al.*, 2006). On several occasions in Composite Dialogue Building (CDB) economic and commercial cooperation were discussed along with other issues. In economic and commercial cooperation the main points raised by India were SAFTA and MFN where Indian views were that Pakistan should give MFN status without any delay (Lodhi, 2011).

That is the reason that debate has been going deciding the time frame for granting MFN to India in accordance with WTO. This debate is in under discussion in different parts of the government, around the business circles and off-course think tanks (Sehgal, 2009).

There are some problems associated with MFN. The writer explains that some countries have to face serious situations after signing MFN where some of their products face special tariff rates as a result of which other suppliers can take advantage of it. The writer further says that in such situations the countries has to find other alternating solutions (Yeats, 1994)

3. ESTIMATIONS

3.1. Stationary Analysis

Log Total Trade (ln_{tt}) between India and Pakistan is stationary at First difference without the Intercept and Trend, as the absolute value ADF Test statistics (6.31) for Log Total Trade (LN_{TT}) is greater than Test critical values at 1%, 5% and 10% respectively, at Probability value near Zero. Hence, we reject Null hypothesis of the unit root, this than implies that our data of D(Log Total Trade (ln_{tt})) is stationary. Log GDP of Pakistan (ln_{ypk}) is stationary at First difference with the Intercept and Trend, as the absolute value ADF Test statistics (5.9) for Log GDP of Pakistan (ln_{Ypk}) is greater than Test critical values, (4.2), (3.5) and (3.1) at 1%, 5% and 10% respectively, at Probability value near Zero. Hence, we reject Null hypothesis of the unit root, this than implies that our data of D Log GDP of Pakistan (ln_{Ypk}) is stationary. Log Import of Pakistan (ln_{mpk}) from India is stationary at First Difference without the Intercept and Trend, as the absolute value ADF Test statistics (5.01) for Log import of Pakistan (ln_{mpk}) is greater than Test critical values, (2.6), (1.9) and (1.6) at 1%, 5% and 10% respectively, at Probability value near Zero. Hence, we reject Null hypothesis of the unit root, this than implies that our data of D(Log import of Pakistan (ln_{mpk})) is stationary. Log Exports of Pakistan (ln_{xpk}) to India is stationary at Surface with the Intercept and Trend, as the absolute value ADF Test statistics (5.54) for Log Exports of Pakistan (ln_{xpk}) is greater than Test critical values, (4.23), (3.5) and (3.2) at 1%, 5% and 10% respectively, at Probability value near Zero. Hence, we reject Null hypothesis of the unit root, this than implies that our data of D (Log Exports of Pakistan (ln_{xpk})) is stationary

3.2. Correlations

Table-1. correlations

	MPK	TT	XPK	YIND	YPK
MPK	1.00	0.24	0.56	0.17	-0.02
TT		1.00	0.71	0.08	0.29
XPK			1.00	-0.05	0.39
YIND				1.00	-0.38
YPK					1.00

Correlation between Export of Pakistan to India (XP) and Total Trade (TT) is (0.71) shows a positive strong significant correlation. Similarly, the correlation coefficient between GDP of Pakistan and Exports of Pakistan to India shows positive and significant correlation (0.38), this thus implies that the association is encouraging for economic growth. Moreover, association between Import of Pakistan from India and GDP growth is negative weak (-0.015) but its significant, which implies that more imports from India relative to the exports to India has negative effect on Pakistan's economic growth. A similar correlation results is absorbed between Export of Pakistan to India (which is Import of India from Pakistan) and GDP growth of India, (-0.056), this than implies that the excess of imports from Pakistan to India has not Positive impact on India's growth. However, the correlation coefficient of Exports of India to Pakistan that is Import of Pakistan from India (0.175) shows positive association with GDP growth of India. The association between GDP growth of India with the Total Trade is positive, significant but weak relatively (0.08); association of Pakistan economic growth and Total trade between India and Pakistan. Hence, Pakistan can get more benefits with the expansion of trade then India.

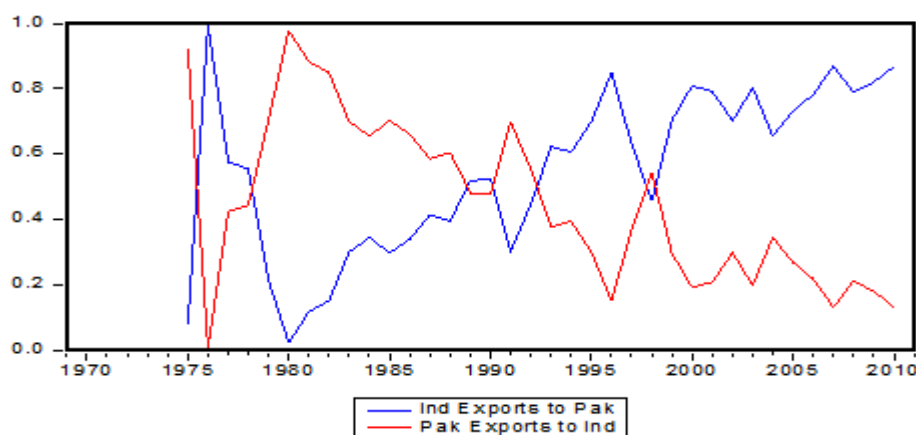
3.3. Equality Test, Mean Comparisons

Table-2. Equality test between groups

Sample: 1969 2011			
Method	df	Value	Probability
Anova F-test	(2, 111)	13.20	0.0000
Welch F-test*	(2, 68.94)	9.054	0.0003

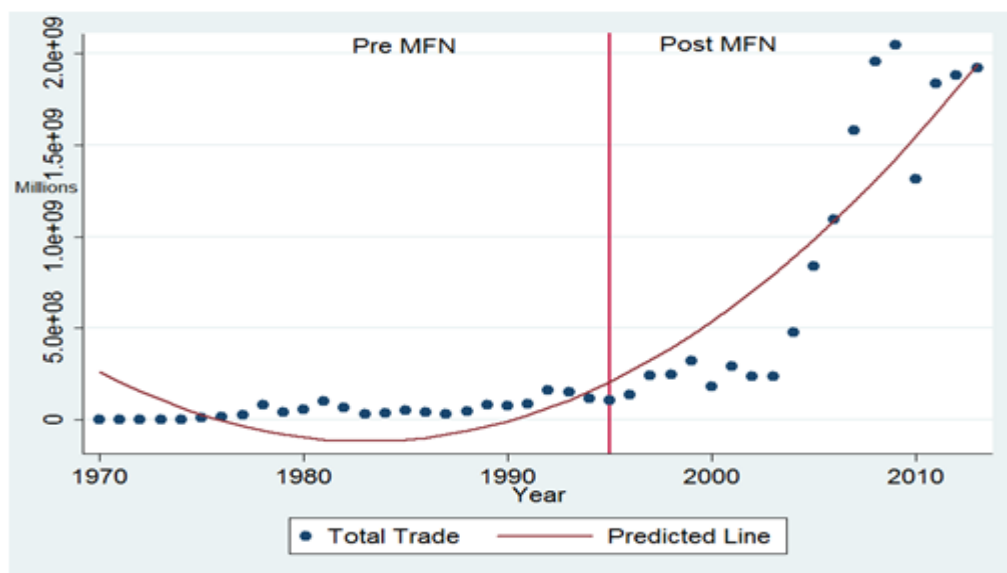
*Test allows for unequal cell variances

Using Welch F-test at 1% level of Significance, we can reject the null hypothesis of equal means for Total Trade. Which thus implies that the trade dimensions before and after the declaration of MFN are not same. Which then implies the potential role of MFN in terms of trade.



Graph-3. Imports and Exports (mill \$) of Pakistan with India. (1969-2011)

Blue line is ratio of Indian Exports to Pakistan with total trade between India and Pakistan, whereas, red line is ratio of Pakistan exports to India with total trade between India and Pakistan. 1994 is the year where India declared Pakistan as Most Favorite Nation (MFN), and we clearly can see from the graph above that trade balance shifted in favor of India since then. Hence, we can confidently say that period with MFN status has significant difference with period without MFN for both India and Pakistan. Where, pre MFN state is in favor of Pakistan in context of trade balance, while post MFN era is clearly better for India.



Graph-4. Pre and Post MFN Impact on Total Trade, IND and PAK (1970-2011)

4. REGRESSION ANALYSIS

	(1)	(2)	(3)	(4)
VAR	Model 1	Model 2	Model 3	Model 4
	YPk	YInd	YPk	YInd
MFN	-0.34	0.23***	-0.15	-0.03
	(0.292)	(0.079)	(0.152)	(0.052)
Pol	0.02	0.04	0.02	0.01
	(0.055)	(0.044)	(0.070)	(0.024)
TT	-0.20**	0.14**	-0.39*	0.14***
	(0.075)	(0.057)	(0.228)	(0.040)
XPk	0.02	0.02	0.11*	-0.04***
	(0.053)	(0.018)	(0.060)	(0.013)
MPk	-0.07	0.08*	0.02	-0.03
	(0.119)	(0.042)	(0.077)	(0.032)
YInd	1.82**		3.12	
	(0.728)		(2.065)	
YPk		0.26***		0.12***
		(0.085)		(0.012)
Trend			-0.09	0.04***
			(0.097)	(0.004)
Constant	-19.63	17.12***	-49.61	20.38***
	(18.628)	(2.290)	(49.362)	(0.557)
Observations	38	38	38	38
R-squared	0.819	0.965	0.839	0.992

Robust standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

4.1. Findings of Model-1 and Model-3; Impact on Economic Growth of Pakistan (YPk)

We tested for YPK in model 1 and 3, where in model 3 we introduced trend to see the real impact. In model-1 and 3, the R-square (0.81) and (0.83) show that the variation in Economic Growth of Pakistan Ypk is explained by the variations in our given independent variables.

In both models 1 and 3, the variable MFN (-0.34, -0.15; $p > 0.05$) shows, negative non-significant impact of economic growth of Pakistan. Which implies that Indian Declaration of MFN status to Pakistan has caused no impact to Pakistani economy.

The dummy of Government Type in Pakistan (Pol) has remained ineffective and insignificant in all four models. Implying that no matter what kind of Government prevailing in Pakistan, its nature would have remained in significant in the economic growth through trade with India.

In model-1, Total Trade (TT; -0.2**, $p < 0.01$) between India and Pakistan, significantly explains the variation in YPk. However, having a significant negative coefficient, -0.2** in model-1 implies that when total trade increases it inversely affects the economic growth of Pakistan. However, when we introduced Trend to the model-1, the impact of TT has increased significantly in model-3, and coefficient increased to -0.39*, $p < 0.05$, validating the negative impact of Total Trade on economic growth of Pakistan.

The variable Export of Pakistan to India (Xpk) is positive but insignificant (0.02, $p > 0.05$) in model-1. However, in model-3, after the introduction of Trend variable, Xpk shows positive and significant (0.11, $p < 0.05$) impact on Ypk. Which thus implies that when export increase to India, it improves the economic growth of Pakistan.

Interestingly, in model-1, when Indian Economy improves (YInd; 1.82*), p value less than 0.05, it positively affects the economic growth of Pakistan. However, when we introduced Trend in Model-3, this impact is no more significant. Which thus implies that economic growth of Pakistan is indifferent of economic growth of India. Which is an evident fact, as Indian economy has maintained a phenomenal growth rate over last decade, whereas the economy of Pakistan has remained under crisis in that entire period.

4.2. Findings of Model-2 and Model-4; Impact on Economic Growth of India (YInd)

Model-2 and 4 are tested to see the impact of our selected variables on economic growth of India (YInd). R-square for model-2 and 4 are 0.96 and 0.99, showing that our independent variables significantly explain the economic growth of India.

The variable MFN, in model-2, shows strong positive and significant (0.23****, $p < 0.00$) impact on YInd. This implies that after declaring Pakistan as most favorite nation, Indian economy has been significantly gaining from the mutual trade. Which had been observed earlier in graph 3 and 4. Where data shows that the post MFN export rate to Pakistan from India has seen phenomenal and exponential growth. However, when we introduce variable Trend, which is positive and significant (0.12****, $p < 0.00$) to the model-2, the impact of MFN (model-4) on YInd not only becomes weak and insignificant but also becomes negative (-0.03, $p > 0.05$). Hence, we could infer that the MFN has not been only source of growth in Indian export to Pakistan, but also the trend has supported the Indian trade. Where domestic industrial growth in India for certain goods and services along with digital media, internet, and globalization let the neighboring country Pakistan to be one of the successful markets.

Whereas, the total trade, TT, showing strong significant and positive (0.14****, $p < 0.00$) impact on YInd in both models 2 and 4. The impact becomes more significant though when we introduce the Trend variable to model-2. Thus implies that over the years total trade has been positively adding value to Indian economy, contrary to its impact on Pakistan.

Impact of Export of Pakistan on YInd is weak and nonsignificant (0.02, $p > 0.05$) in model-2. However, after the introduction of Trend XPk inversely and significantly (-0.04****, $p < 0.000$) impacting the YInd. This thus implies that when Pakistan export to India would increase it would inversely affect the terms of trade between them and

hence the YInd. If we look at the pre MFN era in graph 3 and 4, we see that Pakistan exports remained better comparatively and hence was lower economic growth statistics were observed for Indian economy.

In model-2 imports of Pakistan from India, MPk, is weak positive and significant (0.08*, $p < 0.05$) implying that more imports of Pakistan from India, the economic growth of India would enhance. However, induction of Trend to model-2 changes the nature of and direction of MPk, which becomes non-significant and negative in model-4 (-0.03, $p > 0.05$).

On the other hand impact of economic growth of Pakistan YPk in both models 2 and 4 is positive and significant (0.26***, $p < 0.00$; 0.12***, $p < 0.00$) which implies to very important outcome that the growth of Pakistan economy strengthens Indian economy (reverse is not true).

5. CONCLUSION

India and Pakistan have great prospects in one on one trade relations. On the other hand, these bordering nations never capitalize on mutual trade possibilities and have always found new ways to decrease trade reliance connecting them. Reason being for non-healthy trade regimes are political and non political issues.

In reality, politics have always directed Indo-Pak trade relationships, whereas its base should have been economic welfare. In this course of action, these two countries had to go through enormous economic losses from time to time.

The two neighbors have fought three and half wars with each other based upon false perceptions, backed by terrorist attacks, which didn't allow development in their mutual trade relations. Besides, it also forced them in spending a good share of their GDP on military.

Mutual trade between India and Pakistan has been taking place by means of land and sea-routes, where Wagha border holds key position in land routes. They are engaged with remote partners for trade and trade between them can be divided into formal, informal, and circular trade.

Different trade speculations regarding possible profits for the two countries have been made which accounts from \$ 2 billion to \$ 5 billion. Besides, cost reduction in transport and transshipment, which both India and Pakistan have to bear while trading with remote partners, major portion of illegal trade can be brought into main stream.

Furthermore, from the correlation and regression analysis show that MFN significantly explains Indo-Pak total trade. Where, India has been benefited more than Pakistan as both the MFN and economic growth of Pakistan are significantly healthy for Indian economy. However, the trend also remained the vital factor in shaping the course of trade especially after nineties, which again favored India more than Pakistan.

In 1951-52 total trades between the two countries were \$ 113.79 million in which Pakistan imports from India accounted for \$ 0.08 million whereas its exports had a combine share of \$ 113.71 million. The whole picture changed after 1995 where in the year 2010-11 total trade that took place was \$ 2,007.4 million, between the two countries in which Pakistan imports were \$ 1,743.1 million, and its exports to India were \$ 264.3 million. From this scenario one can infer that Pakistan not granting MFN to India is justified. On the broader terms one can argue that by granting MFN Pakistan can have enormous benefits, like India got benefit in terms of trade after declaring Pakistan as MFN.

Pakistan has never reciprocated with announcing MFN for India, and has always increased its potential list items. Bilateral trade relations between the two countries are very important where Pakistan will have access to billion people market, advanced technology, reduction in costs, whereas India will have access to Central Asia and Afghanistan. Similarly, it will also get access to natural resources in order to maintain its growth rate resulting in profits for Pakistan as a transit fees.

Once Indian economy is dependent on its neighbor's stability, Pakistan can negotiate issues like; tariffs, non-tariffs, custom duty, local taxes and issue of Jammu and Kashmir. These measures will also help Indo-Pak to reduce

defense expenditures and to focus on key issues, which includes safe drinking water, food, shelter, and jobs for the people.

Thus by granting MFN to India, the whole region will be forwarded towards development and growth in almost every aspect. It is not clear from the results the amount of profit for Pakistan yet the estimates are high. The example we have here is that of U.S. and Vietnam, where Vietnam got economic and welfare profits. Similar results can be drawn for Pakistan, which has additional benefits of sharing long territorial border, language, and culture.

6. RECOMMENDATIONS

According to recent development in bilateral trade relations both India and Pakistan signed visa issues in which many facilities are given to businessmen community. As no current data is available on this pact it is necessary not to comment on that. Whereas it is important to highlight that such steps will not only strengthen their mutual relationship but will also let them grow in all directions. The steps that Pakistan should take for further development while granting MFN to India are listed below;

- i. Categories the industries which will be facing Indian competition and formulate reasonable protection;
- ii. Demand India to bring down tariffs and non-tariffs problem that are associated with trade and business;
- iii. Ask India to allow Pakistani made agriculture products enter into India on priority basis;
- iv. Work with India to promote mutual cooperation in the field of education, information technology and most importantly the energy sector.
- v. Include India to CPEC and allow their renewable sector explore potentials in Pakistan.

Only a calculated, best fitted and protected MFN to India would increase the possibility for Pakistan to level up the total terms of trade with India.

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Appendix

A.1. OLS Regression

Impact of MFN on Pakistan

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
VARIABLES	Xpk	Xpk	Xpk	Mpk	Mpk	Ypk	Ypk	TT	TT
log_gdppak			-0.09 (0.116)	1.04** (0.452)	-0.12* (0.058)				-0.25** (0.103)
political dummy	-0.04 (0.389)	-0.40 (0.385)	-0.29 (0.265)		0.03 (0.153)	0.23 (0.150)	0.07 (0.050)	0.34 (0.268)	0.01 (0.068)
log_importpk			-0.84* (0.458)				-0.09 (0.101)		0.39*** (0.115)
Most Favorite Nation	1.61*** (0.411)	-0.86 (0.540)	-0.71 (0.419)	2.14*** (0.466)	-0.09 (0.236)	1.18*** (0.183)	-0.36 (0.262)	2.35*** (0.290)	0.16 (0.152)
log_total_trade		0.78*** (0.162)	1.45*** (0.389)		1.08*** (0.284)		0.08 (0.152)		
trend		0.03 (0.053)	0.09 (0.077)		0.08 (0.053)		0.08*** (0.025)		-0.10*** (0.037)
log_exportpk					-0.42*** (0.105)		-0.03 (0.061)		0.31*** (0.093)
log_gdpindia									2.36*** (0.784)
Constant	3.29*** (0.220)	-10.84*** (2.258)	-19.38*** (5.780)	-22.65** (11.119)	-13.58** (5.298)	24.23*** (0.095)	22.07*** (2.624)	17.59*** (0.161)	-38.62** (17.601)
Observations	39	39	38	38	38	44	38	39	38
R-squared	0.328	0.675	0.787	0.776	0.947	0.538	0.745	0.664	0.970

Robust standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

Impact of MFN On India

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
VARIABLES	YInd	YInd	YInd	xpk	xpk	xpk	mpk	mpk	mpk
log_exportpk		0.00	0.00						
		(0.016)	(0.015)						
log_importpk		0.04*	0.04**		-0.83*	-0.81*			
		(0.021)	(0.019)		(0.434)	(0.429)			
political dummy	0.10*	0.03	0.02	-0.38	-0.21	-0.21		0.25	0.21
	(0.058)	(0.030)	(0.029)	(0.381)	(0.221)	(0.220)		(0.264)	(0.207)
Most Favorite Nation	0.33***	-0.05	-0.01	-0.65*	-0.79**	-0.70*	0.40**	0.28	0.31
	(0.095)	(0.072)	(0.066)	(0.382)	(0.386)	(0.363)	(0.185)	(0.385)	(0.308)
trend		0.05***	0.04***		0.23	0.25		0.16***	0.04
		(0.005)	(0.004)		(0.140)	(0.151)		(0.032)	(0.101)
log_total_trade	0.33***			0.92***	1.68***	1.76***	0.70*		0.68*
	(0.034)			(0.146)	(0.483)	(0.520)	(0.364)		(0.399)
log_gdppak			0.19***			0.39		-0.14	-0.21
			(0.014)			(0.235)		(0.114)	(0.232)
log_gdpindia				0.09	-2.81*	-3.91*	1.08		0.67
				(0.540)	(1.636)	(2.221)	(0.870)		(1.850)
Constant	20.32***	25.29***	22.36***	-15.21	46.04	63.40	-38.05**	3.46	-22.61
	(0.596)	(0.071)	(0.292)	(13.477)	(35.984)	(45.182)	(16.820)	(2.410)	(38.200)
Observations	39	38	38	39	38	38	38	38	38
R-squared	0.929	0.982	0.988	0.669	0.814	0.822	0.913	0.883	0.918

Robust standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

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