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Pivot to Geoeconomics and Pak-Iran Relations: Prospects for Trade Cooperation

Author: Tauseef Javed & Syed Zulfiqar Ali*

Key Points:

- The total trade value between Iran and Pakistan is 392.08 million dollars, with 22.86 million dollars worth of Pakistani exports.
- Pakistan's export portfolio viz Iran is relatively limited as only rice makes up 63 per cent of Pakistan's total exports to its western neighbour.
- Even with sanctions, Iran in 2021 was the third largest producer of dry natural gas, increasing its natural gas output by 60 per cent between 2011 and 2021, approximately 8.8 trillion cubic feet per year.
- If the Iran-Pakistan pipeline had been completed and operational on time, Pakistan would have had access to a cheaper natural gas source rather than having to set up the infrastructure and then import LNG.
- Currently, Pakistan does not undertake many imports from Iran in the energy sector, the main being around 100 megawatts of electricity for Gwadar, which up till 2010 used to be 35 megawatts.
- Both countries should formalise the long-delayed FTA, while Pakistan should diversify its export basket in order to overcome the trade imbalance.

INTRODUCTION

Pakistan is a vast and expanding market for both energy and economy. The country's population is above 200 million people, ranked as the fifth most populous country in the world.¹ Pakistan's signature on the China-Pakistan Economic Corridor (CPEC), a venture with a total budget of 62 billion dollars, has provided an internal impetus to shift Pakistan's foreign policy orientation from geostrategy to geoeconomics

¹ "Pakistan Population (2023)," *Worldometer*, accessed January 10, 2023, <https://www.worldometers.info/world-population/pakistan-population/>.

* Tauseef Javed works at the Centre for Strategic and Contemporary Research (CSCR) as a Research Associate. He is currently enrolled as a doctoral student at Fujian Normal University in Fuzhou, China. His research focuses on international relations, history, and area studies from an interdisciplinary perspective.

* Syed Zulfiqar Ali has completed his Masters in Defence & Strategic Studies from Quaid-i-Azam University, and is currently serving as a Research Assistant at the Centre of Strategic and Contemporary Research.

recently.² This shift provides an intriguing economic opportunity for the regional countries, especially Iran, to reevaluate Pakistan's significance. The study aims to provide a contemporary overview of the vast region in which the two countries are situated in the backdrop of Pakistan's aspiration towards geoeconomics. This will allow for an examination of Pakistan's shift toward geoeconomics, and the potential realities of the Pak-Iran shared neighbourhood, both of which call for a much greater level of policy cohesion in the presence of trade-related impediments. Because of the nature of the relationship, the majority of the analyses and arguments regarding the economic relations between Pakistan and Iran are based on reports and data

² Madiha Afzal, "'At All Costs': How Pakistan and China Control the Narrative on the China-Pakistan Economic Corridor," *Brookings* (blog), June 15, 2020, <https://www.brookings.edu/research/at-all-costs-how-pakistan-and-china-control-the-narrative-on-the-china-pakistan-economic-corridor/>; "Pakistan's Strategic Shift from Geo-Politics to Geo-Economics," *Pakistan Today*, accessed January 10, 2023, <https://www.pakistantoday.com.pk/2022/02/15/pakistans-strategic-shift-from-geo-politics-to-geo-economics/>.

extracted from sources such as the government's official websites and newspaper sources.

This perspective paper analyses the existing trade regimes and barriers in how both countries forge future relations, particularly in the bilateral trade domain. The relevance of potential prospects sprouted from the changed geopolitical dynamics of South Asia, particularly after the inclusion of Pakistan into China's Belt and Road Initiative (BRI) and Pakistan's post-Covid announcement of tilt to geoeconomics. This paper discusses existing trade regimes, the volume of bilateral trade, and the impediments on the way. Moreover, recommendations are presented at the end of this paper.

CURRENT TRADE VOLUME AND TRADE REGIMES

The total trade value between Iran and Pakistan is 392.08 million dollars, with 22.86 million dollars worth of Pakistani exports consisting primarily of rice, meat, paper and paper board, chemicals, textiles, fruit, and vegetables. Major imports from Iran consist primarily of iron ore, hides and skins, and chemical products, with Pakistani imports totalling 369.23 million dollars.³ Rice makes up 63 per cent of Pakistan's total exports to Iran, which means that Pakistan's export portfolio is relatively limited. The current trade is conducted under the signed preferential trade agreement (PTA) in 2006, under which Iran received tariff concessions on 309 tariff lines, while Pakistan received concessions on 338 tariff lines during the last round of trade negotiations held in 2021. Rice, fruits, cotton, cotton yarn, cotton products, medicinal products, and cutlery were some of the major industries that the PTA covered.⁴

In 2017, all parties agreed that the planned FTA would be finalised by the end of that year. When it was projected that the agreement would increase bilateral trade from 300 million dollars in 2016 to five billion dollars by 2021, the trade negotiating committee of both countries held two rounds of discussions on the Free Trade Agreement (FTA).⁵ However, both countries still have not formalised FTA, and the absence of a viable payment mechanism is considered one of the obstacles to recognising FTA. In order to increase bilateral trade in the face of the United States (US) sanctions, Tehran and Islamabad decided to use barter

trade in November 2021.⁶

Private Business Cooperation

In order to strengthen the private partnerships from both sides, the Federation of Pakistan Chambers of Commerce and Industries (FPCCI) and the Iran Chamber of Commerce, Industries, Mines and Agriculture (ICCIMA) signed three Memorandums of Understanding (MOU) in October 2022, intending to increase commerce. Additionally, on 3 December 2022, Iran's Trade Promotion Organisation (TPO) declared that the government had approved the importation of all goods covered by Iran-Pakistan under the PTA.⁷ It will allow aspirants of the trade from both sides to increase existing bilateral trade.

Major Irritants

Pakistan and Iran share some irritants that halt the progress of bilateral trade between the two neighbouring countries. A brief description of the major irritants is given below:

- **US and European sanctions on Iran:** Despite requests by Pakistani exporters and dealers, Pakistani banks have been hesitant to offer Letters of Credit (LC) for export to Iran due to multiple US/international sanctions imposed on Iran.⁸
- **Absence of payment mechanism:** As there is no credible and regulated mechanism of payment infused by the above-mentioned irritant, it creates a void that compromises the bilateral trade between the two countries.⁹
- **Geopolitical concerns:** It has been observed that Pakistan kept compromising its trade relations with Iran. This is at the cost of maintaining good relationships with states which have competing geopolitical interests with Iran.

IRAN - PAKISTAN PIPELINE

Iran had been proposing a pipeline to export gas to Pakistan and India since the discovery of the South Pars gas field in 1990. This led to discussions and then the signing of an agreement for the Iran-Pakistan pipeline, which was signed in 1995. The US has opposed the project from the first day, leading to the belief that if the

³ "Pakistan-Iran Relations," *Ministry of Foreign Affairs*, accessed January 6, 2023, <https://mofa.gov.pk/news-items/>.

⁴ Sohail Sarfraz, "Promotion of trade: Pakistan, Iran sign 32-point MoU," *Business Recorder*, June 2, 2022, <https://www.brecorder.com/news/40177237/promotion-of-trade-pakistan-iran-sign-32-point-mou>.

⁵ Mubarak Zeb Khan, "Pakistan, Iran Set \$5bn Trade Target by 2023," *DAWN*, November 7, 2021, <https://www.dawn.com/news/1656473>.

⁶ "Iran, Pakistan Explore Ways to Strengthen Bilateral Trade," *Tehran Times*, December 24, 2022, <https://www.tehrantimes.com/news/480050/Iran-Pakistan-explore-ways-to-strengthen-bilateral-trade>.

⁷ Ibid.

⁸ Ghulam Abbas, "Pakistan, Iran Operationalise Barter Trade," *Profit: Pakistan Today*, July 5, 2022, <https://profit.pakistantoday.com.pk/2022/07/05/pakistan-iran-operationalise-barter-trade/>.

⁹ Ibid.

pipeline is ever completed, Pakistan will face sanctions to deter it from using the pipeline.¹⁰ The two countries were responsible for constructing the seven-billion-dollar pipeline within their own territory, and by 2011, Iran had completed its part of the pipeline. It even offered Pakistan a loan of 500 million dollars to aid in completing its portion of the pipeline on time at the end of 2014.¹¹

In February 2019, Tehran sent Islamabad formal correspondence that if Pakistan were to back out of the deal, Iran would seek legal action, as an agreement signed in 2009 stipulated that the pipeline must be finished by the end of December 2014. Pakistan then stated that work on or completion could lead to the Trump administration imposing sanctions on Pakistan. Iran's view at the time was that the pipeline was not subject to US sanctions.¹²

Even with sanctions, Iran in 2021 was the third largest producer of dry natural gas, increasing its natural gas output by 60 per cent between 2011 and 2021, approximately 8.8 trillion cubic feet per year. Iran's natural gas reserves are the second largest behind Russia.¹³ Pakistan agreed to import 274 billion cubic feet of natural gas starting in December 2014, which was to be the end of the construction phase of the pipeline. Pakistan was unable to construct its part of the pipeline due to numerous reasons.¹⁴

For the past few years, Pakistan has been in a difficult economic and financial position, and adding to that fact is the pressure from the US not to complete the pipeline. This was especially true in the Trump era when the US pulled out of the Joint Comprehensive Plan of Action (JCPOA) and re-imposed sanctions on the sale of Iranian oil and gas.¹⁵ Pakistan also has to manage its relations with Saudi Arabia. Following a visit by the then Crown Prince and the current King of Saudi Arabia, Salman bin Abdulaziz Al-Saud, in 2014, Shahid Khaqan Abbasi, the then petroleum and natural resources minister of Pakistan, told the National Assembly that the pipeline was no longer on the cards given international

embargos.¹⁶

Pakistan has, since the mid-2010s, been importing Liquefied Natural Gas (LNG) to deal with the shortfall in local production. According to a report by the State Bank of Pakistan, 23 per cent of the gas used in the country was imported LNG.¹⁷ This import of LNG as a whole and the need at times for spot buying, having higher rates, puts a massive strain on the balance of payments, as the rates for LNG and transport can fluctuate with the demand. The same has been witnessed since the start of the Russia-Ukraine war as Europe is looking for other gas sources. Pakistan also had to deal with international suppliers defaulting on cargo, leading to fuel and power shortages.¹⁸

If the Iran-Pakistan pipeline had been completed and operational on time, Pakistan would have had access to a cheaper natural gas source rather than having to set up the infrastructure and then import LNG. In September 2022, Iran's Ambassador to Pakistan stated that Iran is still keen to work on the Iran-Pakistan pipeline to boost bilateral trade and cooperation. The Ambassador stated that there were no sanctions on Iran's gas, and as such, Iran is ready to complete the pipeline and fully cooperate with Pakistan in the field of energy.¹⁹ There is also renewed interest in the Government of Pakistan to complete the pipeline lately due to the increase in LNG prices and its shortage in the international market.²⁰ It is safe to say that the long-term benefits of the Iran-Pakistan pipeline outweigh both its financial and political costs.

IRAN'S ENERGY EXPORTS TO PAKISTAN

Currently, Pakistan does not undertake many imports in the area of energy from Iran, the main being around 100 megawatts of electricity for Gwadar, which up till 2010 used to be 35 megawatts. Pakistan has, according to reports, asked to increase this amount to 200 megawatts, but this would not be possible till issues

¹⁰ "Iran, Pakistan Ignore US," *Deutsche Welle*, March 11, 2013, <https://www.dw.com/en/iran-and-pakistan-start-gas-pipeline-despite-us-warnings/a-16664212>.

¹¹ Haroon Janjua, "US Sanctions Hamper Iran-Pakistan Pipeline Deal," *Deutsche Welle*, May 20, 2019, <https://www.dw.com/en/iran-gas-pipeline-deal-with-pakistan-hampered-by-us-sanctions/a-48802450>.

¹² Aamir Saeed, "Gas Pipeline Project 'Impossible' under US Sanctions, Pakistan Tells Iran," *Arab News*, May 11, 2019, <https://www.arabnews.pk/node/1495251/pakistan>.

¹³ "Iran," *U.S. Energy Information Administration*, accessed January 10, 2023, <https://www.eia.gov/international/analysis/country/IRN>.

¹⁴ "Iran," *U.S. Energy Information Administration*, accessed January 11, 2023, <https://www.eia.gov/international/analysis/country/irn/background>.

¹⁵ *Ibid.*

¹⁶ Khuldune Shahid, "Are Saudi Riyals Blocking Iran Pakistan Pipeline?," *The Friday Times*, March 7, 2014, <https://www.thefridaytimes.com/2014/03/07/are-saudi-riyals-blocking-iran-pakistan-pipeline/>.

¹⁷ "Special Section: LNG Sector in Pakistan," In *State Bank of Pakistan Second Quarterly Report 2020-2021* (Karachi: SBP, June 2021), 103-134, <https://www.sbp.org.pk/reports/quarterly/fy21/Second/Special-Section.pdf>.

¹⁸ "Pakistan's Dependence on Imported LNG Exacerbates Energy Insecurity and Financial Instability," *IEEFA*, June 16, 2022, <https://ieefa.org/articles/pakistans-dependence-imported-lng-exacerbates-energy-insecurity-and-financial-instability>.

¹⁹ "Iran Ready to Complete Gas Pipeline Project: Ambassador," *The Express Tribune*, September 7, 2022, <https://tribune.com.pk/story/2375238/iran-ready-to-complete-gas-pipeline-project-ambassador>.

²⁰ Ahmad Ahmadani, "Iran-Pakistan Gas Pipeline Project Is Back on the Table," *Profit: Pakistan Today*, October 19, 2022, <https://profit.pakistantoday.com.pk/2022/10/19/iran-pakistan-gas-pipeline-project-is-back-on-the-table/>.

with the transmission lines are solved. As such, the two countries have agreed to upgrade the transmission lines in their respective territories.²¹ Iran recently shared a draft MoU to export around 5000 megawatts of electricity to Pakistan. This MoU details how the relevant infrastructure would be constructed, where and what fuel it will use, and other technical details.²² This is not the first time Iran has offered large amounts of electricity to Pakistan. Previously, in 2015, Iran offered to export 1000 megawatts and look at the possibility of adding another 3000 megawatts to that. The rates offered then were much cheaper than local production rates,²³ but this did not materialise.

More recently, in July 2022, Iran's National Iranian Oil Company and Russia's Gazprom signed agreements to jointly export natural gas to Pakistan and Oman.²⁴ This was after the two companies signed an agreement worth 40 billion dollars to together develop on-and-offshore gas and oil fields.²⁵

Then, at the end of December 2022, Russian Deputy Prime Minister Alexander Novak stated that his country was looking at ways to export gas to Pakistan and Afghanistan via Iran. There are two ways this would happen. Either Iran would supply its gas to Pakistan in return for getting Russian gas, or Russia would have existing infrastructure in Central Asia. The swap option would also help Iran facing a shortage in its northern region. Supply of Russian gas via Central Asia would therefore be used in the said northern region, and in return, Pakistan would get gas from Iran.²⁶ Either way, it could be a cheaper or more readily available option for Pakistan as compared to LNG.

The main difficulty in energy exports from Iran to Pakistan is the method of payment. Due to the sanctions on Iran, large banking transactions cannot be undertaken. Most of the bilateral trade between Iran and Pakistan is via barter. Pakistan does not have a diverse

enough export basket required by Iran or a large export volume for it to undertake meaningful energy trade with Iran.

RECOMMENDATIONS

In light of the above discussion, it can be inferred that both countries should incorporate the following recommendation in their policy circles.

- Both countries should formalise the long-delayed Free Trade Agreement (FTA).
- Pakistan should diversify its export basket in order to overcome the trade imbalance.
- Trade in local currencies can be opted to mitigate the effect of US sanctions.
- From a broader perspective, China's growing influence can play a positive role in completing the Iran-Pakistan gas pipeline.
- Pakistan should seriously work with Iran to complete the Iran-Pakistan pipeline, it would not only increase bilateral trade and boost ties with Iran, but it would also be cheaper than the LNG we are currently using.
- Pakistan should look to increase the electricity imports from Iran as it would be cheaper than the electricity made in Pakistan, and the emissions from the gas-burning plants will be lower than the coal and oil-burning plants in Pakistan.
- The option of getting Russian gas via Iran should also be explored; again, Russian gas would be a cheaper option than LNG. Russian involvement may also help in the completion of the Iran-Pakistan pipeline to receive Russian gas.
- The Iran-Pakistan pipeline could be linked to CPEC and lead to Iranian gas exports via Pakistan to China, as China is currently the third largest gas consumer globally.

²¹ Hamid Waleed, "100MW Power Supply to Gwadar: Iran, Pakistan to Upgrade Existing Transmission Line," *Business Recorder*, June 22, 2022, <https://www.brecorder.com/news/40181896/100mw-power-supply-to-gwadar-iran-pakistan-to-upgrade-existing-transmission-line>.

²² Mushtaq Ghumman, "5000MW Electricity Export: Iran Shares MoU Draft," *Business Recorder*, August 19, 2022, <https://www.brecorder.com/news/40192510>.

²³ Ahmad Fraz Khan, "Iran Offers Electricity at Low Tariff," *DAWN*, February 11, 2015, <https://www.dawn.com/news/1162842>.

²⁴ "Iran, Russia to Export Gas to Oman, Pakistan as Part of Joint Project," *Sputnik International*, July 27, 2022, <https://sputniknews.com/20220727/iran-russia-to-export-gas-to-oman-pakistan-as-part-of-joint-project-1097858999.html>.

²⁵ "Iran Wants To Work With Russia's Gazprom To Build Gas Pipelines To Pakistan & Oman," *Silk Road Briefing*, July 28, 2022, <https://www.silkroadbriefing.com/news/2022/07/28/iran-wants-to-work-with-russias-gazprom-to-build-gas-pipelines-to-pakistan-oman/>.

²⁶ "Moscow Considering Gas Export to Pakistan through Iran," *Tehran Times*, December 28, 2022, <https://www.tehrantimes.com/news/480176/Moscow-considering-gas-export-to-Pakistan-through-Iran>.