



Center for Iranian Studies in Ankara

PAKISTAN-IRAN RELATIONS: ECONOMIC AND POLITICAL DIMENSIONS

Amber Imtiaz





Copyright

Copyright © 2019 Center for Iranian Studies in Ankara (İRAM).

All rights reserved. No part of this publication may be fully reproduced, distributed, transmitted, displayed, published or broadcast without the prior written permission from İRAM. For electronic copies of this publication, visit iramcenter.org. Partial reproduction of the digital copy is possibly by giving an active link to www.iramcenter.org

The views expressed here do not necessarily reflect the views of İRAM, its staff, or its trustees.

For electronic copies of this report, visit www.iramcenter.org.

Editor: Jennifer Enzo

Graphic Design: Hüseyin Kurt

Center for Iranian Studies in Ankara

Oğuzlar, 1397. St, 06520, Çankaya, Ankara / Türkiye

Phone: +90 (312) 284 55 02-03 | Fax: +90 (312) 284 55 04

e-mail : info@iramcenter.org | www.iramcenter.org

Pakistan-Iran Relations: Economic and Political Dimensions

İktisadi ve Siyasi Boyutlarıyla Pakistan-İran İlişkileri

ابعاد اقتصادی و سیاسی روابط ایران و پاکستان

Amber Imtiaz:

Amber Imtiaz

Amber graduated from the University of Azad Jammu and Kashmir, Pakistan with distinction in 2007 and was awarded a gold medal. She holds an MS degree in Economics from the same University. Currently, she is pursuing her PhD from Ankara Yildirim Beyazit University, Turkey. Amber has a particular research interest in growth, institutions and international economics.

CONTENT

| | |
|--|-----------|
| Summary | 3 |
| 1. Introduction | 4 |
| 2. Non-Economic Relations Between Iran And Pakistan | 4 |
| 2.1. History | 4 |
| 2.2. Pak-Iran relations and the US factor..... | 6 |
| 2.3. Recent situation of Pak-Iran relations..... | 6 |
| 3. Economic Relations Between Pakistan and Iran | 7 |
| 3.1. Trade | 7 |
| 3.2. CPEC | 10 |
| 3.3. Iran-Pakistan (IP) Gas Pipeline..... | 11 |
| Conclusion | 12 |
| References | 13 |

List of Figures

| | |
|--|----|
| Figure 1: Percentage change in bilateral trade volume..... | 9 |
| Figure 2: Iran-Pakistan Pipeline Project | 11 |

List of Tables

| | |
|---|---|
| Table 1: Share of Pakistan’s trade volumes with Iran (Million USD)..... | 8 |
|---|---|

List of Abbreviations

| |
|---|
| P5+1 Signatories of the JCPOA: The US, France, Germany, China, Russia, and the United Kingdom |
| GDP Gross Domestic Product |
| CENTO Central Treaty Organization |
| RCD Regional Cooperation for Development |
| IAEA International Atomic Energy Agency |
| PTA Preferential Trade Agreement |
| TTFA Transit Transport Framework Agreement |
| LCCI Lahore Chamber of Commerce and Industry |
| CPPB China Petroleum Pipeline Bureau |
| UAE United Arab Emirates |
| FTA Free Trade Agreement |
| ECO Economic Cooperation Organization |
| ECOTA Economic Cooperation Organization Trade Agreement |
| CPEC China-Pakistan Economic Corridor |
| LNG Liquid Natural Gas |
| TAPI Turkmenistan, Afghanistan, Pakistan and India |
| BOP Balance of Payment |

SUMMARY

- Pak-Iran relations can be seen mainly from two distinguishable lenses; economic and non-economic.
- A strong cultural and historical connection exists between the two countries while there is also huge potential for economic cooperation.
- To broaden the economic ties between the two countries, the long-standing IP gas pipeline project needs to be completed on a priority basis.
- Both countries must explore other workable payment mechanisms such as trade in local currencies to mitigate the effects of US sanctions.
- The Chinese factor is highly important in shaping future Pak-Iran relations. Implementation of the CPEC will diminish US influence and bring the two states closer.

Keywords: Pakistan, Iran, Trade, Economics Relations, History.

ÖZET

- Pakistan-İran ilişkilerine temel olarak ekonomi ve ekonomi dışı boyutlardan yaklaşılabilir.
- İki ülke arasında güçlü kültürel ve tarihi bağlar olduğu gibi ekonomik iş birliği için de çok büyük bir potansiyel mevcuttur.
- İki ülke arasındaki ekonomik bağları geliştirmek için öncelikli olarak uzun zamandır devam eden IP gaz boru hattı projesinin tamamlanması gerekmektedir.
- ABD yaptırımlarının etkisini azaltmak için her iki ülke de yerel para ile ticaret yapmak gibi uygulanabilir alternatif ödeme mekanizmaları üzerinde çalışmalıdır.
- Çin faktörü, Pakistan - İran ilişkilerinin gelecekte takip edeceği seyirde son derece önemlidir. CPEC'in uygulanması ABD'nin etkisini azaltacak ve iki devleti daha da yakınlaştıracaktır.

Anahtar Kelimeler: Pakistan, İran, Ticaret, Ekonomik İlişkiler, Tarih

چکیده

- روابط ایران و پاکستان را می توان به صورت کلی از دو منظر عمده اقتصادی و غیر اقتصادی مورد بررسی قرار داد.
 - این پژوهش نشان می دهد که در کنار پیوندهای فرهنگی و تاریخی قوی میان ایران و پاکستان، پتانسیلهای زیادی برای همکاریهای اقتصادی نیز بین دو کشور وجود دارد.
 - گسترش روابط اقتصادی بین دو کشور نیازمند اولویت دهی به پروژه طولانی مدت خط لوله گاز مایع میان دو کشور است.
 - هر دو کشور جهت کاهش اثر تحریمهای ایالات متحده نیازمند استفاده از ساز و کارهای پرداخت مالی جایگزین مانند استفاده از ارزهای ملی می باشند.
 - عامل چین در شکل گیری روابط آینده پاکستان و ایران بسیار مهم است. پیاده سازی دالان اقتصادی پاکستان-چین (CEPC)، نفوذ ایالات متحده را کاهش داده و سبب نزدیکی بیشتر دو کشور می شود.
- کلید واژه ها:** پاکستان، ایران، تجارت، روابط اقتصادی، تاریخ.

1. Introduction

Pakistan and Iran share deep linguistic, historic and cultural ties. These ties are visible in modern day Pakistan with classic Persian poetry on many contemporary buildings. Their amicable relations date back to the 1947 partition of the subcontinent. Moreover, Iran was the first country to recognize the newly established state of Pakistan. The countries soon developed a strong relationship and signed an official treaty of friendship in 1950. During the long era of the Cold War, they remained allies and shared a harmonious strategic outlook during the Shah's era. Furthermore, Pakistan was the first state to recognize the Islamic Revolution in Iran. During the Iran-Iraq war of the 1980s, despite enormous pressure on Pakistan to support Iraq, Pakistan explicitly expressed its support to Iran. However, the warmth in bilateral relations has been tested on several accounts such as the civil war in Afghanistan, sectarian tension, US influence on Pakistan, sanctions on Iran, and Pakistan's ties with Saudi Arabia.

In recent times, both countries are making serious efforts to overcome persistent irritants for stronger bilateral relations. Both sides are committed to exploring areas of mutual economic interests including trade and gas pipeline projects. Iran, being rich in its natural resources of oil and gas, is crucial for an energy deficient country such as Pakistan.

Pakistan has a population of 209 million with a per capita income of \$1,560. It is a developing economy with a GDP of \$313 billion and an estimated real growth rate of 5.83%. The agriculture sector of Pakistan's economy covers one-fifth of output and provides two-fifths of employment. The industrial sector accounts for only 19% of its output, while the services sector contributes 56.3%. Textiles and apparel account for more than 50 percent of Pakistan's exports. The country faces a serious challenge of trade deficit with exports around \$21 billion and imports \$48.51 billion. Moreover, given demographic challenges, Pakistan's latest challenges include; the bal-

ance of payment deficit, development of the energy sector, and increase in foreign investment to reach the optimal economic growth required for the employment of the increasing urban population, particularly those under twenty-five (CIA, 2018).

This paper attempts to explore the magnitude and diversity of the relationship between Pakistan and Iran during the last seventy years. The next section attempts to analyze non-economic relations between the two neighboring countries. In the third section, an attempt is made to explore economic relations and trade potential among the two countries and finally, the study concludes with an analysis.

2. Non-Economic Relations Between Iran and Pakistan

2.1. History

Pakistan and Iran are two neighboring countries that not only share a common border but also have many other commonalities such as; linguistic, socio-economic, and strong historical, ethnic, cultural, and religious ties. Ethnically, the people of Iran and Pakistan belong to the Aryans (Ahmed, 2014). Spiritual and religious connections among Shiite and Sufi followers brought Iran closer to the hearts of the masses in Pakistan. However, the governments of the two countries have long maintained a reliable connection due to business networks and century-old trade routes. Persian culture has profoundly shaped Pakistani food, dress, music, poetry, and architecture. Furthermore, until the rise of the British regime in India, the Persian language remained the official communication tool of the Mughal Empire. Moreover, through its great poets such as Hafiz, Rumi, Saadi, and Khayyam, etc., Persian influence can be seen in Urdu, the official language of Pakistan. Further, political support to the Iranian nation by Muslims of British India indicates deeper connections between the two Muslim communities. The All-India Muslim League passed a resolution in 1940 in favor of Reza Shah Pahlavi when foreign forces were occupying Iran. After Paki-

stan's independence in 1947, Iran was the first country to accept this newly founded nation.

Pakistan relations with Iran faced different eras, some better and some bitter. During 1947 to 1965, Pakistan successfully maintained good relations with the Muslim world, including Iran. A good era of Pak-Iran relations started due to co-membership of CENTO by both neighboring countries. The connections deepened after the RCD was formed in 1964 by Pakistan, Turkey, and Iran. The good relations of Iran and Pakistan are evident from Iran's sincere effort to settle the rupture that lasted for 22 months during the early 1960s between Pak-Afghan relations. The only potential problem that could have abruptly emerged was a border settlement between Iran and Pakistan. However, the two countries had successfully settled this problem until December 1967. During the 1965 Pak-India War, Iran joined Turkey to support Pakistan, two years later, Pakistan joined Iran to support the Arab world against the war with Israel. Moreover, in 1967 Pakistan gained good relations with Malaysia due to Iran's mediation (Qureshi, 1968).

In the late 1960s, Pakistan faced turmoil and upheaval which eventually resulted in the division of Pakistan in 1971. The separation of Eastern Pakistan weakened the country. This was the time when Pakistan was politically weak, and Iran was continuously gaining strength particularly after the British exit from Suez. The Oil Embargo of 1973 further strengthened the role of Iran in the region which was trying to substitute the British dominance in the region. Pakistan and Iran had good trade relations in this decade. During the years 1974-75 and 1976-77 trade volume between Pak-Iran increased four times and reached 848 million Rupees (Pakistan, 2016-17).

Having growing ties with Iran since independence, Pakistan's relationship with Iran faced a serious decline after the rise of the Islamic Revolution. With the rise of an Islamic ideological regime in Iran, the US became its rival and with it the start of a challenging era for Pa-

kistan's foreign policy towards Iran. The tension between the US and Iran peaked when American Diplomats were taken hostage by Iranian revolutionary students. Consequently, Pakistan adopted a diplomatic stance over the hostages held in Tehran by the revolutionary students (Mohammadally, 1979).

Following the aftermath of the Iranian Islamic Revolution, the US was seen as Iran's archrival and this view negatively influenced Pak-Iran relations. This was during an era when Pakistan was of great importance to the United States against its war with the Soviet Union in Afghanistan. Military dictator General Zia-ul-Haq was ruling Pakistan and maintained a strict pro-Saudi posture. Unfortunately, this Saudi-US alignment of Pakistan's foreign policy made Iran indignant with Pakistan. The policies of General Zia such as state involvement in religious affairs annoyed the Shia communities of Iran and Pakistan. Sectarian tension between Shiites and Sunnites became inflamed as a result of lugubrious incidents that took place including the assassination of Iranian Diplomat Sadiq Gangi in Lahore (Hussain, 1993) and the 1997 killing of five Iranian Airforce cadets in Islamabad (Iqbal, 1997). Furthermore, in the 1990s, Iran's stance on the Kashmir issue changed; at times Iran supported the right of self-determination and later supported the bilateral resolution (Pasha, 2000).

Moreover, in the 1990s, India - a decades-old rival of Pakistan - came closer to Iran when Iran offered India access to central Asian countries. The other major factor that strengthened India and Iran ties was the Pak-Saudi joint support of the Taliban in Afghanistan (Pasha, 2000). On one side, Pakistan was supporting the Taliban and on the other side, Iran was backing the Northern Alliance. Pakistan and Iran failed to cooperate on the Afghanistan issue after the emergence of the Taliban government in 1994 (Khawaja, 2004). Furthermore, in 1998, the Taliban murdered several Iranian diplomats in the northern Afghan city of Mazar-i Sharif and, consequently, Iran almost invaded Afghanistan (Stone, 2018).

2.2. Pak-Iran relations and the US factor

To understand Iran-Pakistan relations, Iran-US relations are unavoidable in the analysis. The two most important elements of tension between Iran-US relations are oil and nuclear technology.

After Pakistan's independence, the world observed healthy relationships between Iran and the United States. Iran started its nuclear technology program "Atoms for Peace" in the 1950s, ironically it was the US that supplied the first research reactor to Iran in the 1960s. Later in the 1970s, after the oil crisis, the US was eager to find investment opportunities in Iran, particularly a nuclear power plant. The contracts that the Shah made with the US regarding the nuclear program were canceled by the Islamic regime. Until 2002, Iran's nuclear program was negligible to the US, but the problem arose when the US claimed that Iran advanced its nuclear fuel cycle technologies. The International Atomic Energy Agency (IAEA), in its 2003 report, mentioned that Iran should fully cooperate to ensure transparency in its nuclear activities (General, 2003). The US views Iran as a major threat to its might in the Gulf region. Moreover, in 2006, the UN Security Council imposed sanctions on Iran as a punishment for a non-satisfactory response on halting the nuclear program (Security Council, 2006). Iran, is of great importance to Pakistan in terms of economy and security, as both countries stood with each other in past. Pakistan could not afford to be part of any military adventure in Iran as it did not join a military collation against Iraq.

Pakistan's association with Iran was also influenced by US dissidence on the Iran-Pakistan gas pipeline project (Security Council, 2006). It is reported by some analysts that the US offered Pakistan to destabilize Iran in 1984 through Baluchistan (Hussain, 1993). No doubt, the US factor plays a significant role in reshaping Pak-Iran relations. Concordant dealings with a resourceful neighbor required Pakistan to tolerate US pressure.

After the lift of sanctions on Iran, the last two years indicated enormous enthusiasm from Tehran and Islamabad to cooperate for bilateral gains. However, recent tweets by US President Donald Trump showed Washington's compelling dissatisfaction with Iran's nuclear behavior. President Rouhani declared Trump's statement to pull out of the nuclear deal as "psychological warfare". However, Pakistan is supporting Iran by persuading the US to keep negotiations on and not to pull out of the nuclear deal (G. News, 2018). The United States is irked by the growing connections and exchange of visits between the high-ups of Pakistan and Iran, moreover, the United States has explicitly advised Pakistan to eschew Iran as much as possible (Nation, 2017). On 6 August, President Trump announced two stage sanctions on Iran. Trump had already proclaimed to withdraw from the Iran nuclear deal, also known as the Joint Comprehensive Plan of Action, this May. In this situation, Pakistan will face onerous challenges in furthering ongoing collaboration with Iran.

2.3. Recent situation of Pak-Iran Relations

After the sanctions were lifted by Western powers in 2016, a quick response from both neighbors was witnessed. Pakistan and Iran initiated exchange visits to boost mutual effort at all levels that were halted due to sanctions. They sought to improve all categories of cooperation including the military. On July 16, 2018, Iranian Chief of General Staff Major General Mohammad Bagheri's visit to Pakistan further strengthened their efforts (Syed, 2018).

Pakistan and Iran seek partnership in developing a junction between the Chabahar and Gwadar ports, but Iran is suspicious of Pakistan-Saudi ties, however, this entente could help millions of Pakistanis living below the poverty line (Nation, 2018b). On 13 April 2018, a high-level Iranian delegation visited the Karachi Port Trust in hopes of improving economic and marine investment. The Iranian delegation was headed by Minister of Roads and Urbanization

which demonstrated an interest in the alliance of transshipment cargo handling and religious tourist facilitation through the link between the Karachi Port and the Bandar Abbas Port (Dawn, 2018a).

The Iranian commander expressed the desideratum for further collaboration between the two neighboring countries in the spheres of politics, economy, and defense (Dawn, 2018b). Regarding the Afghan issue, the Iranian commander's visit was the continuance of cooperation over the Afghan issue by the two neighboring countries after the visit of Pakistan Foreign Minister Khawaja Asif to Iran in September 2017 (T. E. Tribune, 2017).

Pakistan and Iran have a common border where Baluchistan meets the Sistan province. Border security is a perpetual issue for the preservation of both countries. However, in a recent meeting of the Pak-Iran Joint Border Commission, several issues of border security and initiatives for local business markets were settled (Tribune, 2017).

Pakistan and Iran aimed at collaborating with each other on several grounds. Moreover, corruption, which is a menace to progress, is challenged by both countries through mutual effort. The Iranian Attorney General visited Islamabad to meet the National Accountability Bureau Chairman to cooperate in anti-corruption measures in the two neighboring countries (Zafar, 2016c). Furthermore, by controlling oil smuggling, Pakistan could save \$71 million annually, although due to lack of security per-sonnel that seems impossible. Subsequently, the Pak-Iran Joint Border Commission in its 19th meeting pledged to give legal structure to this trade for controlling illegal smuggling (Zafar, 2016b).

Despite some unpleasant incidents in 2016 (Zafar, 2016a), the sincere efforts by the two neighboring countries remained resolute. In August 2016, the Iranian Industry president visited the Chamber of Commerce Peshawar and vowed to enhance trade cooperation (Tribune,

2016). Additionally, unlike other Muslims countries that boycotted Doha, as part of the blockade against Qatar, Pakistan stayed neutral with Qatar, a close ally of Iran, and secured a gas deal (Stone, 2018).

In 2015, Pakistan had made intelligent moves which helped to win Iranian confidence; such as the Pakistani parliament's resolution to not supply troops to fight in the Saudi let war in Yemen and to maintain neutrality in the conflict (Stone, 2018). Moreover, after the US announcement to pull out from the JCPOA, Pakistan expressed its reservations and explicitly condemned the decision (T. E. Tribune, 2018).

3. Economic Relations Between Pakistan and Iran

3.1. Trade

The 1979 Islamic Revolution in Iran not only changed the political-strategic outlook of both countries but also led to the deterioration of economic ties. Moreover, despite immense trade potential, the volume of trade remained modest.

As illustrated above in table 1, bilateral trade volume between Pakistan and Iran, which amounted to \$622 million in 2006 and \$583 million in 2007 surpassed the magic figure of \$1 billion in 2008. The total volume of trade stood at \$1.16 billion in 2008 and reached \$1.21 billion and \$1.1 billion in 2009 and 2010 respectively. Notwithstanding an encouraging trend after 2007, the volume of bilateral trade severely suffered after the new phase of sanctions on Iran that specifically targeted Iran's banks. Trade turnover between Pakistan and Iran dropped to \$457 million in 2011. Moreover, the post-sanctions downfall in total bilateral trade volume continued in the subsequent years and fell to \$229 million in 2014. After the 2015 withdrawal of some sanctions on Iran, the bilateral trade volume showed slight improvement. Subsequently, total trade volume in 2016 reached \$359 million, out of which \$323 million were imports and \$36 million were exports.

Table 1: Share of Pakistan's trade volume with Iran (Million USD)

| YEAR | EXPORTS | IMPORTS | BALANCE | TOTAL |
|------|---------|---------|---------|-------|
| 2005 | 178 | 363 | -185 | 541 |
| 2006 | 179 | 443 | -264 | 622 |
| 2007 | 146 | 437 | -291 | 583 |
| 2008 | 426 | 738 | -312 | 1164 |
| 2009 | 252 | 956 | -704 | 1208 |
| 2010 | 182 | 884 | -702 | 1066 |
| 2011 | 153 | 304 | -151 | 457 |
| 2012 | 142 | 120 | 22 | 262 |
| 2013 | 63 | 168 | -105 | 231 |
| 2014 | 43 | 186 | -143 | 229 |
| 2015 | 32 | 261 | -229 | 293 |
| 2016 | 36 | 323 | -287 | 359 |
| 2017 | 27 | 327 | -300 | 354 |

Source: <https://comtrade.un.org>

Figure 1 shows the percentage change in bilateral trade volume between Pakistan and Iran. The total volume of trade increased by 99.9 percent in the year 2008, feeding Pakistan's hopes that it could achieve a new peak in the future. This trend continued for a couple of subsequent years but unfortunately, in the aftermath of sanctions on Iran, total trade volume plummeted by 57 percent in 2011. The total value of Pakistan's export to Iran in 2011 dropped by 16%, while the total value of imports declined by 66 percent in the same year. The figure shows a decreasing trend of trade until 2014. Although trade turnover showed a slight improvement in 2015 and 2016 and increased by 28 percent and 23 percent respectively, however, the current volume of trade is well below the one billion mark.

Pakistan's major export commodities to Iran include textile, food items including meat, rice, gelatin, derivatives, and mechanical machinery such as paper and wood (Shabbir, 2016). Iran's key export items to Pakistan are iron ore, dates, crude oil, iron scrap, transformers, etc. Notably, Pakistan is the first country that started import-

ing Iran's iron ore (Alam, 2004). However, the current volume of bilateral trade doesn't reflect the potential level.

The literature on the Pakistan-Iran trade connection highlights a number of reasons that contributed to the low volume of trade. These include; economic sanctions against Iran, lingering mistrust, the absence of a banking channel, high non-tariff barriers, smuggling, poor infrastructure connectivity, and high rates of tariffs on commodities in which Pakistan enjoys a comparative advantage such as textiles (Shabbir, 2016).

A series of initiatives have been aimed at harvesting the full potential of trade between Pakistan and Iran. Both countries signed a Preferential Trade Agreement (PTA) in 2004, which was ratified in 2005 and has been operational since. Under this contract, both nations agreed to enhance trade flow by reducing customs duties on 647 tradable commodities. Pakistan agreed to give concessions on 338 tradable items and Iran granted tariff concessions on 309 items (F. Tribune, 2017).

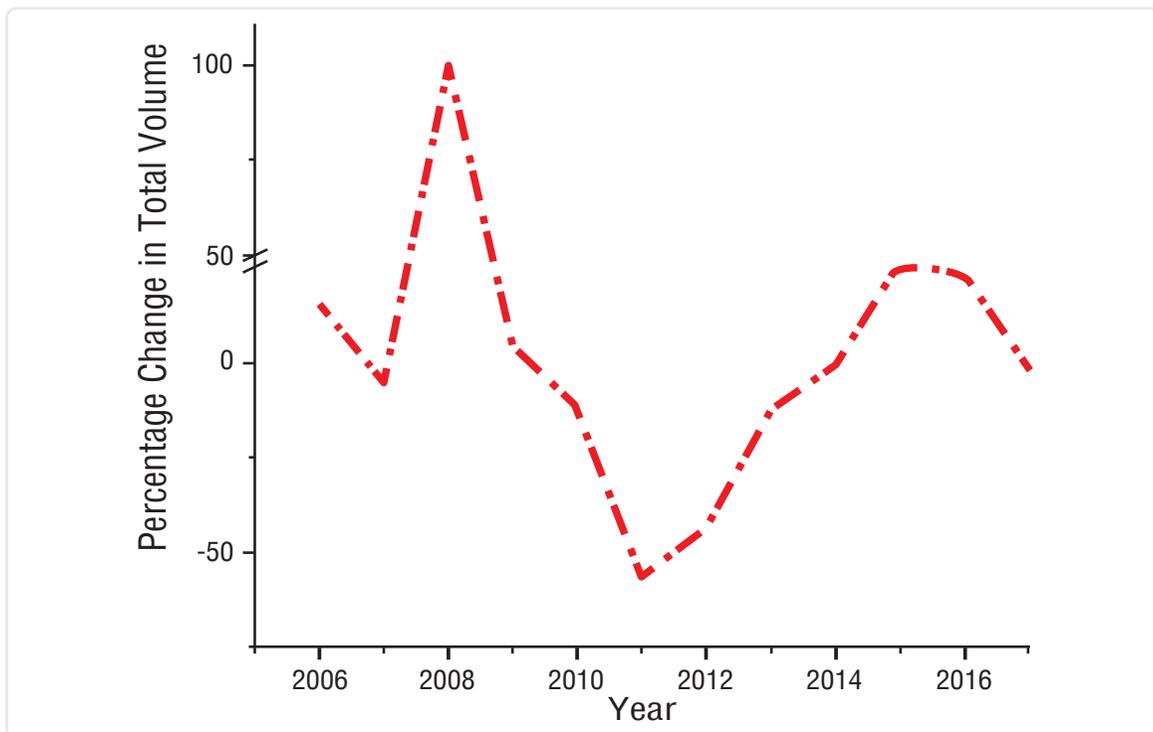


Figure 1: Percentage change in bilateral trade volume

Under the existing Iran-Pak PTA, Pakistan is utilizing concessions on only 12 out of the top 50 exported commodities, while Iran enjoys a preferential tariff on 22 items exported to Pakistan. Due to this poor utilization, it seems appropriate to review this PTA. The absence of a banking channel due to international sanctions on Iran is one of the main reasons why the PTA remained virtually dysfunctional (Malik, 2018). To further reduce the trade barriers and to explore new avenues for expanding trade, both countries decided to finally merge the PTA into an FTA. In the wake of the last stage of the FTA negotiation, Pakistan and Iran have finalized the draft of the FTA, which will be implemented in 2018 (Islamabad, 2018).

Both Pakistan and Iran are members of the ECO. Under the umbrella of the ECO, Pakistan, Iran, and three other countries signed an agreement of ECOTA in 2003. The objective of the ECOTA is to establish a free trade area among the member states. However, this agreement has not been implemented due to a difference in interpretation of the articles related to tariff

reduction. The functioning of ECOTA will be a milestone in realizing the goal of the elimination of trade barriers (Khan, 2013).

In addition to these, Pakistan, Iran, and Turkey have taken other initiatives, including the establishment of an ECO Trade and Development Bank, which became operational in 2008 with a representative office in Karachi and the headquarters in Turkey. The bank's objective was to mobilize and utilize the financial resources for fostering the investment among the member countries.

One of the key trade facilitation measures is to improve connectivity and infrastructural development. To achieve this, one of the major plans for enhancing trans-regional trade is to build rail and road networks. Pakistan, Iran, and Turkey agreed to establish a rail corridor, namely the Islamabad-Tehran-Istanbul (ITI) Rail and Road Corridor. The corridor aims to build a 6,500 km rail network to link Central Asian and European countries; it is presently in the operationalization process. Furthermore, Pakistan's

railway has already started freight operations between Zahidan (Iran) and Quetta (Pakistan). Although, there is still a pending decision for the revival of “Gul Train”- an Istanbul-Islamabad cargo train (Rafique, 2016). Another collective venture to facilitate and enhance infrastructure capacity is the ECO Transit Transport Framework Agreement (TTFA). This agreement, comprised of eight protocols approved in the 3rd ministerial meeting of the ECO on Transport and Communications (Today, 2017), is a deliberate movement to reduce transport cost by accelerating transport services through the modernization and harmonization of transit transport in the region. Due to the absence of banking channels in the wake of US embargos on Iran, a major obstacle in Pak-Iran bilateral trade is the inconvenient and indirect business route via the UAE. However, Iran’s compliance to curb its nuclear program in 2015, and the subsequent lifting of some of the sanctions in 2016, paved new ways for Pakistan to revive trade ties with Iran. Nevertheless, with the presence of some continuing US sanctions Pakistani banks remain reluctant to facilitate its Iranian counterpart. In other words, Pakistani commercial banks are hesitant to accept the transaction process by opening a letter of credit due to fear of black lash from Washington. To solve this predicament, in April 2017, central banks of both countries signed an agreement for a “payment arrangement”. According to this agreement, the central banks authorized some banks in their respective countries to accept transactions in yen or euro to facilitate trade transactions (F. Tribune, 2018). Furthermore, both countries have agreed to materialize a currency swap contract to facilitate bilateral trade (Haq, 2018).

3.2. CPEC

CPEC is a vast investment initiative between the world’s time-tested friends, Pakistan and China. The expected cost of the project is estimated at \$51.5 billion. CPEC involves investment in infrastructure and energy projects along with the construction of a special economic zone (Hanif, 2017).

CPEC is considered a game changer for Pakistan, China, and the region, as it will provide a new, short route for regional countries to connect with the world. Currently, South Asia lags in economic convergence and infrastructure connectivity. However, with its growing strategic position, the demand for economic integration and regional connectivity is rapidly rising. Moreover, by enhancing regional connectivity and reducing transportation cost, CPEC will facilitate economic integration of the whole region. Under this initiative, the current sea routes, as well as trading costs, will be considerably reduced from the Middle East and Africa to East Asia (Qingyan, 2017). Therefore, CPEC is expected to give an impetus to achieve growth and stability in the region (OBSERVER, 2017). Furthermore, it will facilitate Pakistani trade with Central Asia and enable Pakistan to become the trade hub between South Asia, Central Asia, and the Middle East via Iran. Iran borders the Caspian Sea, the Gulf of Oman and the Persian Gulf, and its neighboring countries are Pakistan, Iraq, Afghanistan, Azerbaijan, Turkey, Armenia and Turkmenistan. Initially, Iran opposed the corridor perceiving it as an economic threat and contender to the Chabahar Port. However, Tehran has recently shown an interest in CPEC with the goal to expand trade by improving roads and railways connectivity. Furthermore, CPEC will provide a more convenient route to export Iran’s mega resources of oil and gas (Bilal, 2017).

In September 2016, Iranian President Dr. Hassan Rouhani formally expressed his desire to join CPEC in sideline meeting held at the 71st UN General Assembly Session with then Pakistani Prime Minister Mian Muhammad Nawaz Sharif (T. NEWS, 2016). This desire was reinforced by Iranian Ambassador Honardoost in addressing the Oxbridge Lecture in Islamabad in 2017. He insisted that since Iran is rich in energy resources and technology it would be able to significantly contribute to CPEC. Moreover, Pakistan and China have acknowledged Iran’s inclination to join the project.

CPEC includes the construction of the Chinese funded LNG terminal at Gawadar Port and 700 km long pipelines to import LNG from China. This project can be extended to become the Iran-Pakistan pipeline stated by the former petroleum Minister on July 2015 (BHADRAKUMAR, 2015). The new route would provide the shortest course to connect China with Iran’s mega gas fields (Butt & Butt, 2015). With the inclusion of Iran in CPEC, the most contentious issue of the Iran-Pakistan gas pipeline could be dovetailed and renamed as the Iran-Pakistan-China pipeline (Bilal, 2017). This trilateral relation can emerge as strong economic allies that will promote peace, harmony, and prosperity in the region.

3.3. Iran-Pakistan (IP) Gas Pipeline

The IP gas pipeline was conceived early in the 1990s. It was initially the Iran-India-Pakistan gas pipeline project but later in 2009, India withdrew due to security and pricing issues. The IP gas pipeline covers a distance of around 1900 kilometers which will transfer natural gas from Iran to Pakistan.



Figure 2: Iran- Pakistan Pipeline Project

The above figure shows the IP gas pipeline route with a distance of 1150 kilometers starting from Asalyuyeh (massive South Pars gas field), Iran up to the Iranian border to be built and operated by Iran. While, Pakistan’s liability is to construct the remaining section of around 780 kilometers, starting from Makran- Coastal Highway up to the off-take point at Nawabshah (Nation, 2018a).

It is a pivotal project for an energy deficient country like Pakistan. Among the alternative options in consideration to meet energy requirements, the IP gas pipeline is the most viable and sustainable project in terms of cost and geographic location (MUNIR, 2014). Its importance is evident from the fact that the expected gain from the project is around \$200 million in direct income (Essays, 2018). With Pakistan’s escalating energy demand and the chronic demand-supply gap over time has exacerbated the importance of this project many folds. Unfortunately, it took almost two decades to sign a final deal on the IP gas pipeline project. Both sides inked a final agreement in March 2010, in Turkey (Haider, 2010).

In September 2012, it was announced to commence the project before October 2012 and be completed by the end of December 2014 (Fallahi, 2018).

Iran has already completed its part of the project, however, due to a funds deficiency, Pakistan has not commenced the project. Investors were circumspect to fund the IP gas line project under US sanctions on Iran (Panda, 2015). The US showed displeasure towards the project a number of times and threatened Pakistan not to indulge in any economic ties with Iran (George, 2013). The US continuously took a hard position on the IP gas pipeline project and tried to inhibit Pakistan from materializing the project; moreover, it engaged Pakistan in alternative projects such as the TAPI gas pipeline project to meet energy requirements. Although the TAPI pipeline is backed by the US, chances to complete this project are quite remote due to security concerns in Afghanistan. Pakistan completely realizes the importance of the IP pipeline project, that’s why it didn’t abandon the project despite US pressure, whereas India withdrew under US pressure (Baloch).

However, Pakistan risks paying penalties to Iran as it failed to complete construction within due time. In 2016, the China Petroleum Pipeline Bureau (CPPB) had shown its willingness to provide funds for the completion of the un-built portion of 80 km from Gawadar to the Iranian bor-

der, although both sides couldn't sign a formal agreement so far (Panda, 2015). The completion of the IP gas pipeline is imperative for strengthening Pakistan-Iran economic ties.

CONCLUSION

Historically, Pakistan and Iran relations have been inconsistent; with many twists and turns over the years. Currently, there are remarkable challenges ahead to Pakistan's sustainable relations with Iran. Moreover, Pakistan and Iran, despite being the immediate neighbors, have fallen short of harvesting full economic potential. However, both countries fully realize the importance of each other in the region and are striving to improve strained relations. Negotiations and agreements, whether operational or in progress, reveal determination from both sides to move forward.

To broaden the economic ties between the two countries, the long-standing the IP gas pipeline project needs to be achieved on a priority basis. This project is in the best interest of an energy deficient country like Pakistan. Moreover, initiatives taken to overcome the problems of high tariffs, the absence of banking channels, and improved infrastructure connectivity need to be materialized for fully attaining the trade

potential. Furthermore, trade can be the defining features of Pak-Iran relations. In wake of sanctions on Iran, trade ties grievously suffered and fell below \$50 million. Both countries need to explore other workable payment mechanisms, such as trade in local currencies, to mitigate the effects of sanctions by the US. Moreover, the US attitude towards Iran repeatedly hindered Pakistan-Iran economic engagements. The US's recent decision to withdraw from the JCPOA bring about serious implications for Pak-Iran ties. In this situation, Pakistan's newly formed government will face hard challenges in advancing ongoing cooperation with Iran. Pakistan needs to minimize its losses after the US withdrawal from the JCPOA by looking at alternative solutions. China's factor can play a major role in this regard. With the growing importance of China in the region and the implementation of CPEC, ultimately this will reduce US influence in the region and help bring the two countries together. Moreover, integrating Iran into CPEC would improve security and economic ties. However, balancing the relation between Iran and Saudi Arabia remains a big challenge for Pakistan's new government.

REFERENCES

- Ahmed, M. (2014). Ancient Pakistan-an archaeological history: Amazon.
- Alam, S. (2004). Iran-Pakistan relations: Political and strategic dimensions. *Strategic Analysis*, 28(4), 526-545.
- Baloch, M. M. U. F. Pakistan-Iran Pipeline Project–A Liberal Perspective.
- Bhadrakumar, M. K. (2015). Iran's 'Look East' policy takes wings. Retrieved from https://www.asiatimes.com/2015/07/opinion/irans-look-east-policy-takes-wings/?_=5985113
- Bilal, S. H. (2017). CPEC: Opportunity for Iran and Pakistan. Retrieved from <http://southasiajournal.net/cpec-opportunity-for-iran-and-pakistan/>
- Butt, K. M., & Butt, A. A. (2015). Impact of CPEC on Regional and Extra-Regional Actors. *The Journal of Political Science*, 33, 23.
- CIA. (2018). The World Factbook. Retrieved from <https://www.cia.gov/library/publications/the-world-factbook/geos/pk.html>
- Dawn. (2018a). Iran eyes CPEC with growing interest after port visit.
- Dawn. (2018b). Iranian commander underlines need for peace in Afghanistan. Retrieved from <https://www.dawn.com/news/1392685/iranian-commander-underlines-need-for-peace-in-afghanistan>
- Essays, U. (2018). Diplomatic Relations Between Pakistan And Iran. Retrieved from <https://www.ukessays.com/essays/politics/diplomatic-relations-between-pakistan-and-iran-politics-essay.php>
- Fallahi, B. E. (2018). IP gas pipeline: A fading opportunity for Pakistan. Retrieved from <https://moderndiplomacy.eu/2018/03/05/ip-gas-pipeline-fading-opportunity-pakistan/>
- General, D. (2003). Implementation of the NPT Safeguards Agreement in the Islamic Republic of Iran. International Atomic Energy Agency, November, 29.
- George, M. (2013). Pakistan starts work on Iranian gas line opposed by U.S. Retrieved from <https://www.reuters.com/article/us-iran-pakistan-gas/pakistan-starts-work-on-iranian-gas-line-opposed-by-u-s-idUSBRE92A09X20130311>
- Haider, Z. (2010). Pakistan, Iran sign deal on natural gas pipeline. Retrieved from <https://www.reuters.com/article/us-pakistan-iran/pakistan-iran-sign-deal-on-natural-gas-pipeline-idUSTRE62G12C20100317>
- Hanif, C. R. M. (2017). CPEC would facilitate Inter Regional Connectivity. Retrieved from <https://pakobserver.net/cpec-facilitate-inter-regional-connectivity/>
- Haq, S. (2018). Currency swap agreement with Pakistan about to materialise: Iranian envoy. Retrieved from <https://tribune.com.pk/story/1701059/2-pakistan-currency-swap-agreement-materialise-iranian-envoy/>
- Hussain, M. (1993). Pakistan-Iran Relations in the Changing World Scenario: Challenges and Response. *Foreign policy debate: The years ahead*, 32(5).
- IQBAL, A. (1997). Five Iranian cadets slain in Pakistan. Retrieved from <https://www.upi.com/Archives/1997/09/17/Five-Iranian-cadets-slain-in-Pakistan/5997874468800/>
- Islamabad, T. O. (2018). Pakistan Iran finalise Free Trade Agreement. Retrieved from <https://timesofislamabad.com/18-Apr-2018/pakistan-iran-finalise-free-trade-agreement>
- Khan, M. Z. (2013). ECOTA yet to take effect. Retrieved from <https://www.dawn.com/news/803504>
- Khawaja, A. S. (2004). Afghanistan: A Factor in Pak-Iran Relations. *Turkish Review of Middle East Studies*, 15, 195-224.
- Malik, S. R. (2018). Sanctions on Iran. Retrieved from <https://nation.com.pk/26-May-2018/sanctions-on-iran>
- Mohammadally, S. S. (1979). Pakistan-Iran Relations (1947-1979). *Pakistan Horizon*, 32(4), 51-63.
- Munir, M. (2014). Iran-Pakistan Gas Pipeline: Cost-Benefit Analysis. Retrieved from <http://www.ipripak.org/iran-pakistan-gas-pipeline-cost-benefit-analysis/>
- Nation, T. (2017). Don't get 'too close' to Iran, US asks Pak. Retrieved from <https://nation.com.pk/13-Nov-2017/don-t-get-too-close-to-iran-us-asks-pak>
- Nation, T. (2018a). Implementation on IP Gas Pipeline Project to be reviewed in 2018-19. Retrieved from <https://nation.com.pk/01-Jun-2018/implementation-on-ip-gas-pipeline-project-to-be-reviewed-in-2018-19>
- Nation, T. (2018b). Improving Pak-Iran Relations. Retrieved from <https://nation.com.pk/14-Mar-2018/improving-pak-iran-relations>
- News, G. (2018). Pakistan says US pullout from Iran deal would hurt efforts to resolve matter. Retrieved from <https://www.geo.tv/latest/194772-pakistan-says-us-pullout-from-iran-deal-would-hurt-efforts-to-resolve-matter>

Pakistan-Iran Relations: Economic and Political Dimensions

- News, T. (2016). Iran expresses its desire to be part of CPEC project. Retrieved from <https://www.thenews.com.pk/latest/151791-Iran-expresses-its-desire-to-be-part-of-CPEC-project>
- Observer, P. (2017). CPEC: The initiative for economic prosperity, opportunities and Institutions. Retrieved from <https://pakobserver.net/cpec-initiative-economic-prosperity-opportunities-institutions/>
- Pakistan, G. O. (2016-17). Pakistan Economic Survey. Retrieved from http://www.finance.gov.pk/survey_1617.html
- Panda, A. (2015). With China's Help, the Iran-Pakistan Pipeline Might Finally Happen. Retrieved from <https://thediplomat.com/2015/04/with-chinas-help-the-iran-pakistan-pipeline-might-finally-happen/>
- Pasha, A. K. (2000). India, Iran and the GCC States: Political Strategy and Foreign Policy: Manas Publications.
- Qingyan, L. (2017). Opportunities and Challenges for CPEC to Promote Regional Stability and Development. Retrieved from http://www.ciis.org.cn/english/2017-07/12/content_9555509.htm
- Qureshi, K. (1968). Pakistan and Iran—A Study in Neighbourly Diplomacy. *Pakistan Horizon*, 21(1), 33-39.
- Rafique, N. (2016). Prospects of Pakistan-Iran Relations: Post Nuclear Deal. *Strategic Studies*, 36(3).
- Security Council, U. N. (2006). Security Council Imposes Sanctions on Iran for Failure to Halt Uranium Enrichment, Unanimously Adopting Resolution 1737 (2006). Retrieved from <https://www.un.org/press/en/2006/sc8928.doc.htm>
- Shabbir, S. (2016). Trade with Iran: Prospects for Pakistan. Retrieved from <http://www.criterion-quarterly.com/trade-with-iran-prospects-for-pakistan/>
- Stone, B. R. (2018). Can Imran Khan Become Tehran's Man in Islamabad. Retrieved from <https://thediplomat.com/2018/07/can-imran-khan-become-tehrans-man-in-islamabad/>
- Syed, B. S. (2018). Pakistan, Iran vow to improve military ties. Retrieved from <https://www.dawn.com/news/1420539/pakistan-iran-vow-to-improve-military-ties>
- Today, P. (2017). Pak, Iran, Turkey establishing road, rail networks to boost trans-regional trade. Retrieved from <https://profit.pakistantoday.com.pk/2017/01/13/pak-iran-turkey-establishing-road-rail-networks-to-boost-trans-regional-trade/>
- Tribune. (2016). Pakistan, Iran should exchange trade delegations. Retrieved from <https://tribune.com.pk/story/1163189/strengthening-ties-pakistan-iran-exchange-trade-delegations/>
- Tribune. (2017). Pak-iran relations: Joint Border Commission meeting ends. Retrieved from <https://tribune.com.pk/story/1342171/pak-iran-relations-joint-border-commission-meeting-ends/>
- Tribune, F. (2017). Iran, Pakistan to Finalize Free Trade Deal by November. Retrieved from <https://financialtribune.com/articles/economy-domestic-economy/73877/iran-pakistan-to-finalize-free-trade-deal-by-november>
- Tribune, F. (2018). Pakistan Loses Iran Market Over Lack of Payment Mechanism. Retrieved from <https://financialtribune.com/articles/economy-business-and-markets/84600/pakistan-loses-iran-market-over-lack-of-payment>
- Tribune, T. E. (2017). Diplomatic contacts: Iran agrees Afghan conflict has no military solution.
- Tribune, T. E. (2018). Tearing up Iran deal: Pakistan counts the cost of Trump move. Retrieved from <https://tribune.com.pk/story/1706197/1-pakistan-concerned-trumps-decision-scrap-iran-nuclear-deal/>
- Zafar, M. (2016a). Iran fires mortar shells into Pakistan. Retrieved from <https://tribune.com.pk/story/1190515/iran-fires-mortar-shells-pakistan/>
- Zafar, M. (2016b). Oil deals: The expected hit to smugglers. Retrieved from <https://tribune.com.pk/story/1046860/oil-deals-the-expected-hit-to-smugglers/>
- Zafar, M. (2016c). Pakistan, Iran agree to enhance cooperation. Retrieved from <https://tribune.com.pk/story/1210308/accountability-pakistan-iran-agree-enhance-cooperation/>



About İRAM

Center for Iranian Studies in Ankara is a non-profit research center dedicated to promoting innovative research and ideas on Iranian affairs. Our mission is to conduct in-depth research to produce up-to-date and accurate knowledge about Iran's politics, economy and society. İRAM's research agenda is guided by three key principles – factuality, quality and responsibility.



Center for Iranian Studies in Ankara

Oğuzlar Mh. 1397. Sk. No: 14 06520 Çankaya, Balgat, Ankara, Turkey
Phone: +90 312 284 55 02 - 03 Fax: +90 312 284 55 04
e-mail: info@iramcenter.org www.iramcenter.org

All rights reserved. No part of this publication may be reproduced or transmitted without the prior written permission of İRAM.