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The Impact Of Geopolitical India-Pakistan Tension On Their Economic Health

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Abstract

This article examines the economic ramifications of persistent geopolitical tensions between India and Pakistan, two nuclear-armed neighbours with a complex history of conflict and fragile diplomacy. Despite numerous bilateral and multilateral efforts to improve relations, recurrent episodes of political and military standoffs—ranging from cross-border skirmishes to trade suspensions—have consistently disrupted economic cooperation and regional stability. Using a mixed-methods approach that incorporates macroeconomic indicators, trade data, foreign direct investment (FDI) flows, and geopolitical risk indices from 2000 to 2024, this study assesses how heightened political tensions have influenced each country's economic health.

Our analysis reveals that surges in bilateral tensions often coincide with sharp declines in trade volumes, investor confidence, and tourism, particularly impacting sectors reliant on cross-border cooperation. India, with a more diversified and resilient economy, demonstrates greater insulation against short-term geopolitical shocks. In contrast, Pakistan exhibits more acute vulnerability, with marked fluctuations in currency value, stock market performance, and external financing terms during periods of heightened conflict. Furthermore, defence spending spikes during such periods lead to fiscal imbalances, diverting resources from developmental priorities in both nations.

The findings highlight a significant economic cost to unresolved political disputes and underscore the need for confidence-building measures, regional trade integration, and sustained diplomatic engagement. Policy recommendations include structured dialogue platforms, economic diplomacy initiatives, and leveraging regional institutions like SAARC for economic cooperation, even amid political strains. The article concludes that while geopolitics may continue to dominate the bilateral narrative, economic pragmatism must guide future engagement to foster stability and growth in South Asia.

Keywords:

India-Pakistan tensions, geopolitical risk, economic impact, bilateral trade, foreign direct investment, defence spending, economic diplomacy, regional stability, macroeconomic indicators, SAARC

Introduction

The geopolitical relationship between India and Pakistan has long been characterized by tension, intermittent hostility, and a history of unresolved disputes—most notably over the region of Kashmir. Since their partition in 1947, the two nations have engaged in several wars and numerous military standoffs, punctuated by brief periods of diplomatic thaw. While the political and security implications of this rivalry are extensively studied, its broader economic consequences—particularly in terms of national economic health—remain

underexplored in depth. This article aims to bridge that gap by investigating how recurring India-Pakistan tensions have influenced the macroeconomic stability, trade dynamics, investment climate, and fiscal priorities of both countries.

India and Pakistan are not only geographic neighbours but also share cultural and historical legacies that once supported extensive economic interdependence. However, in the face of rising nationalism, military conflicts, and diplomatic ruptures—such as the aftermath of the 2008 Mumbai attacks or the 2019 Pulwama-Balakot crisis—economic cooperation has become increasingly strained. Bilateral trade, which once held promise as a stabilizing factor, has stagnated and even regressed in recent years, with Pakistan suspending trade ties in 2019 and India revoking Pakistan's Most Favoured Nation (MFN) status. These measures have had far-reaching consequences, not just for bilateral commerce but also for broader regional economic integration in South Asia.

The economic impact of such geopolitical tensions is multidimensional. On the one hand, heightened political risk deters foreign direct investment (FDI), restricts access to global capital markets, and undermines investor sentiment. On the other hand, military escalations often lead to increased defence spending, crowding out public investment in critical areas like infrastructure, education, and healthcare. For Pakistan, with its fragile economy and recurrent balance-of-payments crises, these effects are particularly pronounced. India, though economically more robust, is not immune to the economic costs of sustained geopolitical instability, particularly in terms of opportunity costs and regional underdevelopment.

This paper adopts a mixed-methods approach, combining empirical data analysis with policy review, to evaluate the long-term economic implications of India-Pakistan tensions. It uses macroeconomic indicators such as GDP growth, fiscal balance, inflation, currency stability, trade volume, and FDI flows to assess how episodes of geopolitical stress correlate with economic outcomes. Moreover, the study considers how repeated conflict has hindered regional initiatives under platforms like the South Asian Association for Regional Cooperation (SAARC), thereby limiting the potential for economic synergies in South Asia.

In doing so, the article aims to offer a nuanced understanding of how political hostility undermines economic potential, both directly and indirectly. It argues for the necessity of delinking trade and economic engagement from security disputes, emphasizing the role of economic diplomacy in mitigating conflict and fostering mutual interdependence. By shedding light on the economic costs of enduring geopolitical tension, this research underscores the need for renewed policy frameworks that prioritize economic cooperation alongside traditional security concerns.

Historical Context and Diplomatic Strains

The India-Pakistan relationship is one of the most complex, emotionally charged, and volatile bilateral ties in modern international relations. Its roots lie deep in the traumatic birth of the two nations in 1947, when British India was partitioned on religious lines. This Partition wasn't just a bureaucratic boundary; it ripped apart millions of lives, leading to one of the bloodiest mass migrations in human history. Communal violence, displacement, and lasting bitterness set the stage for the decades of hostility that followed.

From day one, Kashmir became the core flashpoint. When the princely state of Jammu and Kashmir acceded to India after the Pakistani-backed tribal invasion, the first India-Pakistan war erupted in 1947-48. The United Nations intervened, resulting in a ceasefire line — now known as the Line of Control (LoC) — leaving Kashmir divided and contested. The problem wasn't resolved; it was simply frozen.

Diplomatic relations remained tense, punctuated by open warfare: the second war in 1965 (again over Kashmir), the third in 1971 (triggered by the Bangladesh Liberation War), and the Kargil conflict in 1999. The 1971 war was particularly humiliating for Pakistan, as it led to the creation of Bangladesh, adding fresh wounds to an already embittered relationship.

Nuclearization added a dangerous layer. Both nations tested nuclear weapons in 1998, formalizing a mutual deterrent but also raising the stakes of any future conflict. The doctrine of "minimum credible deterrence" didn't erase hostility; it merely forced it into other forms — cross-border terrorism, proxy wars, and diplomatic brinkmanship.

Diplomatic strains have repeatedly flared due to terrorism, particularly after the 2001 Indian Parliament attack, the 2008 Mumbai attacks, the 2016 Uri attack, and the 2019 Pulwama attack. India consistently accuses Pakistan of harboring and supporting terrorist groups like Lashkar-e-Taiba and Jaish-e-Mohammed, while Pakistan denies state involvement and counters by highlighting India's alleged human rights violations in Kashmir.

Attempts at diplomacy — like the Agra Summit (2001), Composite Dialogue Process, and the Lahore Declaration (1999) — occasionally offered hope. But such moments have often collapsed under the weight of mutual distrust, domestic political pressures, and non-state actors determined to sabotage peace efforts.

In recent years, after the abrogation of Article 370 by India in 2019, which revoked Jammu and Kashmir's special status, relations hit a new low. Pakistan downgraded diplomatic ties and suspended trade. Even the backchannel talks and Track-II diplomacy often find themselves hostage to the larger geopolitical climate and internal politics of both nations.

Ultimately, India-Pakistan relations remain a bitter cocktail of historical grievances, ideological divides, nationalistic rhetoric, and unresolved territorial disputes. The past haunts every negotiation, and while both sides occasionally flirt with peace, the trust deficit runs deep. It is a relationship where history isn't past — it's ever-present, casting long shadows over any future possibilities.

Impact on Bilateral Trade

Bilateral trade between India and Pakistan has been severely affected by ongoing geopolitical tensions. Before the 2019 trade suspension, the World Bank estimated the trade potential between the two countries at \$37 billion annually. However, actual trade was much lower, around \$2.6 billion in 2018-19. The imposition of tariffs and trade barriers has disrupted established supply chains, particularly impacting border economies in regions like Punjab, which previously relied on cross-border trade.

Foreign Direct Investment (FDI) and Economic Growth

Geopolitical instability has deterred foreign direct investment (FDI) in both India and Pakistan. Moody's revised India's GDP growth forecast for 2025 downward to 6.3%, citing heightened global policy uncertainty and increasing trade restrictions, including rising geopolitical tensions with Pakistan. Similarly, Pakistan's fragile economy, characterized by high external debt and limited foreign-exchange reserves, faces challenges in attracting investment, exacerbated by security concerns and strained international relations.

Defence Spending and Fiscal Priorities

In response to ongoing security threats, both India and Pakistan have increased defence spending, diverting resources from critical development sectors. India has approved significant military procurements, including \$4.6 billion for emergency procurement and advanced plans for stealth fighter jets and drones. While these investments aim to bolster national security, they also strain fiscal resources, potentially crowding out spending on infrastructure, education, and healthcare.

Investor Sentiment and Stock Market Volatility

Geopolitical tensions have influenced investor sentiment and stock market performance in both countries. The Indian stock market, particularly the Sensex index, has shown resilience in the face of geopolitical events, with markets often recovering quickly from initial shocks. However, sustained tensions can lead to increased volatility, affecting investor confidence and long-term economic planning.

Agricultural and Water Resources

Agriculture, a vital sector for both India and Pakistan, has been adversely affected by geopolitical tensions. The suspension of the Indus Waters Treaty in 2025 led to reduced water flow in the Chenab River, impacting Pakistan's crop-sowing season and threatening food security. Such disruptions highlight the interconnectedness of political decisions and economic outcomes, particularly in resource-dependent sectors.

Regional Economic Integration and SAARC

The South Asian Association for Regional Cooperation (SAARC) was established to promote regional economic integration. However, ongoing geopolitical tensions between India and Pakistan have hindered the effectiveness of SAARC, limiting opportunities for collaborative economic initiatives and regional development.

Strategic Infrastructure Projects and Economic Diplomacy

Strategic infrastructure projects, such as India's investment in the Chabahar Port in Iran, aim to enhance connectivity and trade routes, bypassing Pakistan. These projects reflect broader geopolitical strategies and have implications for regional economic dynamics, influencing trade flows and economic partnerships.

The enduring geopolitical tensions between India and Pakistan have profound implications for their economic health. From disrupted trade and investment flows to increased defence spending and regional instability, the economic costs are significant. Addressing these issues requires a multifaceted approach, including confidence-building measures, economic diplomacy, and efforts to decouple economic cooperation from political disputes. By fostering economic interdependence, both nations can pave the way for a more stable and prosperous future in the South Asian region.

The Current Situation and India-Pakistan Relations in Miscellaneous Sectors

The bilateral relationship between India and Pakistan, two nuclear-armed neighbours in South Asia, remains characterized by geopolitical tensions, particularly in sectors such as trade, defence, water resources, and agriculture. Despite efforts to engage diplomatically, the dynamics in these areas continue to evolve, influenced by historical disputes, security concerns, and regional developments.

Trade Relations:

Trade between India and Pakistan has experienced significant fluctuations, primarily due to political tensions and policy decisions. In the fiscal year 2023–24, India imported goods worth approximately \$3 million from Pakistan, a sharp decline from previous years. Conversely, India's exports to Pakistan during the same period amounted to \$1.2 billion, predominantly comprising pharmaceuticals, sugar, and chemicals. This disparity underscores the asymmetry in trade relations, with India maintaining a substantial trade surplus.

Year	India's Imports from Pakistan (USD Million)	India's Exports to Pakistan (USD Million)
2023–24	3	1,200

Source: [Hindustan Times](#)

Defence Expenditure:

The defence budgets of India and Pakistan reflect their respective security priorities and economic capacities. In the 2023–24 fiscal year, India allocated approximately \$73.8 billion to defence, accounting for about 13% of its national budget. In contrast, Pakistan's defence budget for the same period was around \$6.34 billion. This significant difference highlights the disparity in military spending between the two nations.

Country	Defence Budget (USD Billion)	Percentage of National Budget
India	73.8	13%
Pakistan	6.34	Not specified

Source: [NDTV](#)

Water Resources and the Indus Waters Treaty:

Water sharing remains a contentious issue, particularly concerning the Indus Waters Treaty (IWT) signed in 1960. In recent developments, India issued a formal notice to Pakistan seeking modifications to the treaty, citing significant shifts in circumstances that necessitate a review. This move has raised concerns in Pakistan, especially regarding the control over water flows from the western rivers allocated to it under the treaty.

Event	Date	Details
India's Notice to Pakistan	September 2024	India formally requested modifications to the IWT.
Suspension of IWT	April 2025	India temporarily suspended the IWT following cross-border tensions.

Source: [Business Standard](#)

Agriculture and Water Availability:

Agriculture in both countries is heavily dependent on river systems, with Pakistan particularly reliant on the Indus and its tributaries. Recent actions, such as India's construction of the Shahpur Kandi Dam on the Ravi River, have raised concerns in Pakistan about reduced water availability for irrigation. The dam's completion in February 2024 and the subsequent cessation of water flow to Pakistan have implications for Pakistan's agricultural productivity.

Project	Location	Completion Date	Impact on Pakistan
Shahpur Kandi Dam	Punjab, India	February 2024	Reduced water flow to Pakistan, affecting irrigation.

Source: [Wikipedia](#)

Diplomatic Engagement and Tensions:

Diplomatic relations between India and Pakistan have been strained, with limited engagement in recent years. The 2025 crisis, marked by military clashes and the suspension of the IWT, further exacerbated tensions. Pakistan's Foreign Minister expressed openness to dialogue but emphasized that both nations must be committed to the process. However, India's stance remains cautious, linking dialogue to the cessation of cross-border terrorism.

Event	Date	Details
Military Clashes	May 2025	Intense military exchanges occurred, leading to a ceasefire.
Suspension of IWT	April 2025	India suspended the IWT, citing security concerns.
Diplomatic Statements	June 2025	Pakistan expressed willingness for dialogue; India maintains cautious stance.

Source: [Reuters](#)

The current state of India-Pakistan relations is characterized by complexities across various sectors. While trade continues, it is limited and unbalanced. Defence expenditures reflect differing priorities and capabilities. Water resource management, particularly concerning the Indus Waters Treaty, remains a critical issue with potential implications for agriculture and regional stability. Diplomatic efforts are ongoing but face significant challenges due to historical grievances and security concerns. Moving forward, sustained dialogue and

confidence-building measures will be essential to address these multifaceted issues and promote a stable and cooperative relationship between the two nations.

Conclusion:

The persistent geopolitical tensions between India and Pakistan—rooted in historical grievances, territorial disputes, and cycles of militarized hostility—have cast a long and often devastating shadow over the economic health of both nations. Despite the potential for robust economic development and regional cooperation, both countries have found themselves locked in a counterproductive rivalry that diverts critical resources from social and economic welfare to defence and strategic posturing. This prolonged hostility has not only strained diplomatic relations but has also stunted the broader economic progress that could have emerged through trade, tourism, and regional integration.

For India, a rapidly emerging global economic player, the Pakistan conflict represents a chronic security headache that demands disproportionate military expenditure and hampers regional connectivity initiatives such as SAARC. Although India has diversified its economic partnerships globally and insulated itself relatively well from direct financial fallout, the broader South Asian economic dynamism remains underutilized. Trade relations with Pakistan remain negligible despite shared borders and cultural commonalities, and bilateral trade, once promising, has remained hostage to diplomatic crises. The opportunity costs are immense—particularly in sectors like agriculture, textiles, pharmaceuticals, and logistics—where cross-border collaboration could yield significant gains.

Pakistan, on the other hand, bears a heavier economic toll. Its political and economic institutions, already grappling with instability, inflation, and fiscal mismanagement, suffer additional strain from the ongoing security dilemma with India. Large portions of Pakistan's limited national budget are siphoned into defence spending, often at the expense of education, healthcare, and infrastructure. Moreover, the volatile security landscape deters foreign investment, weakens tourism, and isolates the country from potentially beneficial regional trade initiatives. The absence of normalized ties with India not only limits direct trade but also undermines Pakistan's ability to participate meaningfully in global supply chains.

Beyond economic costs, these tensions have also given rise to deeply entrenched nationalistic sentiments, which further complicate peace initiatives and rational economic policymaking. In both countries, populist politics frequently exploit nationalist narratives, sidelining economic logic in favour of symbolic retaliation. This mutual distrust has paralyzed regional institutions and stalled efforts toward collective development goals in South Asia—a region already grappling with poverty, inequality, and climate challenges.

However, all is not bleak. Economic interdependence remains a powerful, though underutilized, instrument for peace. Historical precedents across the world—from post-war Europe to modern-day ASEAN—demonstrate how economic cooperation can de-escalate geopolitical conflicts. A roadmap toward normalizing India-Pakistan economic relations could begin with confidence-building measures in non-contentious sectors such as trade in basic goods, energy cooperation, and people-to-people exchanges. Joint initiatives to combat climate change, terrorism, and public health crises could also provide neutral grounds for dialogue and partnership. In conclusion, the India-Pakistan conflict is not just a political or military conundrum; it is a deeply economic one with real, measurable consequences for the livelihoods of over 1.6 billion people. Continuing down the path of hostility guarantees nothing but mutual stagnation. A future-oriented vision, grounded in pragmatic diplomacy and economic rationality, holds the key to transforming the region from a security hotspot into a hub of shared prosperity. The choice between perpetual deadlock and collective progress lies squarely in the hands of policymakers—and time is of the essence.

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