INDIA–PAKISTAN GEOPOLITICAL STALEMATE AND ECONOMIC PERFORMANCE: A STRATEGIC POLITICAL-ECONOMY FRAMEWORK FOR ASSESSING FISCAL REALLOCATION, INVESTMENT UNCERTAINTY, TRADE FRAGMENTATION, GOVERNANCE CONSTRAINTS, SOCIO - ECONOMIC VULNERABILITY, AND REGIONAL DEVELOPMENT

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Abstract

This comprehensive study explores the complex challenges arising from the ongoing geopolitical stalemate between India and Pakistan and their impact on regional economic development. The conflict, rooted in historical disputes, restricts trade, investment, and regional cooperation, leading to significant opportunity costs. Bilateral trade has sharply declined from nearly US$3 billion in 2018 to about US$1.2 billion in 2024, limiting economic growth and regional integration. Both countries divert substantial public resources towards defense and security, reducing spending on social sectors like health, education, and infrastructure, which hampers human development. The persistent tensions also increase economic uncertainty, discourage private investment, and heighten financial market volatility, especially in Pakistan with limited reserves. Behavioral factors like nationalism, threat perception, misinformation, and political polarization further reinforce distrust and confrontation.

Institutional weaknesses and limited diplomatic engagement hinder cooperation on shared issues such as water management, climate change, and regional connectivity. These challenges collectively limit the region's growth potential, with intra-regional trade remaining only about 5% of South Asia's total, far below the estimated potential of US$67 billion. Addressing these issues requires innovative governance, confidence-building measures, phased economic integration, and regional cooperation strategies. Strengthening institutional frameworks and fostering trust can transform the entrenched confrontation into opportunities for sustainable development, regional stability, and improved human welfare. This study highlights the urgent need for collaborative efforts to unlock the vast economic opportunities hindered by prolonged geopolitical tensions. Within this framework, the study examines the major emerging challenges that are increasingly influencing the complex and interconnected nature of the contemporary global environment.

Keywords: **Economic Development, Human Development, Financial Market, Climate Change, Regional Stability, Innovative Governance and Sustainable Development.**

The theme of the article

The India–Pakistan geopolitical stalemate remains a defining challenge impacting regional economic stability and development. This enduring conflict, rooted in historical disputes and strategic rivalries, influences a wide array of economic, political, behavioral, and institutional dynamics across South Asia. Despite significant unrealized economic potential, estimated at over US$44 billion in trade alone, the persistent tensions restrict cross-border trade, investment, regional connectivity, and resource sharing. These restrictions generate substantial opportunity costs, divert fiscal resources toward security and defense, and dampen investor confidence, thereby hindering sustainable growth. Furthermore, the conflict shapes public perceptions, fueling nationalism, threat perceptions, misinformation, and distrust, which reinforce the confrontation and impede cooperation. Institutional fragility, including limited diplomatic engagement and weak regional frameworks, exacerbates these challenges, while recurring crises divert public resources from social development to defense expenditures.

The asymmetric macroeconomic resilience of the two nations, India's larger, diversified economy versus Pakistan's vulnerability, further influences the long-term regional trajectory. This comprehensive analysis underscores the complex interplay of security concerns, political incentives, behavioral mechanisms, and institutional constraints that sustain the stalemate. Addressing these multifaceted issues requires innovative governance frameworks, confidence-building measures, phased economic integration, and regional cooperation strategies. Such efforts aim to transform the entrenched confrontation into a foundation for sustainable economic development, regional stability, and improved human welfare, ultimately unlocking the vast economic opportunities that remain unrealized due to geopolitical tensions.

Statement of the problem

The persistent geopolitical tension between India and Pakistan presents a profound challenge to regional economic stability and development. This stalemate not only hampers bilateral trade, reducing it from nearly US$3 billion in 2018 to about US$1.2 billion in 2024, but also constrains regional integration, investment, and resource cooperation across South Asia. The ongoing conflict elevates uncertainty, discouraging private sector investment, disrupting supply chains, and elevating transaction costs, thereby weakening economic growth prospects. Moreover, the security-oriented fiscal priorities in both countries divert critical public resources away from social sectors such as health, education, and infrastructure, impeding human development and deepening regional disparities. The stalemate also undermines macroeconomic stability, inflates risk premiums, and increases volatility in financial markets, especially in Pakistan, which has limited external buffers. Behavioral mechanisms like nationalism, threat perception, misinformation, and political polarisation reinforce distrust and resistance to cooperation, perpetuating a cycle of conflict and economic isolation.

Furthermore, the environmental and transboundary management of shared resources such as water and climate adaptation is compromised, risking long-term sustainability. This complex interdependence of security, economic, political, and social factors creates a structural constraint that not only impairs current growth but also limits the region's potential to capitalize on its geographical proximity and economic complementarities. Addressing this multifaceted challenge requires integrated governance reforms, confidence-building measures, regional cooperation frameworks, and policies aimed at transforming conflict into constructive economic partnerships, to foster sustainable development and regional stability. Against this backdrop, the study investigates the critical emerging challenges that are shaping the increasingly complex, interdependent, and dynamic global environment of the modern world.

Objectives of the article

The overall objective of the article is to comprehensively analyze the multifaceted challenges stemming from the India–Pakistan geopolitical stalemate and their impact on regional economic performance. It aims to identify key emerging issues such as trade restrictions, security expenditure, investment uncertainty, and behavioral responses that hinder economic integration and growth. Through critical examination of secondary data, the study seeks to quantify the economic costs, explore the influence of institutional and behavioral mechanisms, and assess macroeconomic stability and human development outcomes. The ultimate goal is to provide evidence-based insights to inform policy measures that can foster regional cooperation, reduce opportunity costs, and promote sustainable economic development in South Asia with the help of secondary sources of information and statistical data pertaining to the theme of the article.

Methodology of the article

The study adopts a descriptive, analytical and comparative research design to examine how the prolonged India–Pakistan geopolitical stalemate influences economic performance and regional development. The analysis is based entirely on secondary sources of information and statistical data collected from reliable national and international institutions, including the World Bank, International Monetary Fund (IMF), World Trade Organization (WTO), Asian

Development Bank (ADB), Reserve Bank of India (RBI), State Bank of Pakistan (SBP), Government of India and Government of Pakistan. The World Bank data provide comparable indicators for GDP growth, inflation, unemployment and other macroeconomic variables for both countries. The study covers major dimensions of the geopolitical stalemate, including bilateral trade restrictions, investment uncertainty, defence and security expenditure, financial instability, exchange-rate pressures, employment, human development, institutional effectiveness and behavioural responses. Particular attention is given to the wider regional effects because South Asian intraregional trade remains only about 5% of total regional trade, substantially below its estimated potential.

Descriptive statistics such as percentages, averages, growth rates, ratios and trends are used to identify changes over time. Comparative analysis is applied to examine differences between India and Pakistan and to assess their broader regional implications. Correlation and regression techniques may be employed to examine the association between geopolitical tensions and selected economic-performance indicators, while ANOVA and other appropriate statistical tests can be used to determine whether observed differences across periods or economic dimensions are statistically significant. The study also uses qualitative analysis of policy documents and previous empirical research to explain the institutional, political and behavioural mechanisms underlying the observed economic outcomes. The findings are interpreted in terms of economic opportunity costs, regional integration, resilience and sustainable development, with appropriate limitations concerning data availability, measurement of geopolitical tensions and the difficulty of establishing direct causality. The gathered data are rigorously examined and critically interpreted to generate valuable insights for evidence-based evaluation and informed policy-making.

Review of Literature

The **Asian Development Bank (2023),** examined South Asian economic performance, growth prospects, inflationary pressures, investment conditions, and regional development challenges. The report highlighted the importance of stronger regional economic cooperation, connectivity, and structural reforms for improving resilience. The study provides a regional framework for understanding how geopolitical barriers can affect economic integration and development. **Yoganandham (2022),** examined the strengths, challenges, growth prospects, and factors influencing the transformation of the Indian economy. The study highlighted the importance of structural reforms, investment, employment generation, institutional development, and effective governance for strengthening India's economic performance. The findings provide a useful foundation for understanding the structural factors influencing economic development and resilience. The **International Monetary Fund (2024),** assessed the macroeconomic conditions of South Asian economies, including economic growth, inflation, fiscal pressures, external vulnerabilities, and structural challenges. The report emphasized macroeconomic stability and policy reforms as important requirements for sustaining economic growth. This perspective is relevant to evaluating the economic implications of persistent geopolitical tensions in South Asia.

The **World Bank (2023),** examined regional integration and economic growth in South Asia, with particular emphasis on trade, investment, connectivity, and cross-border economic cooperation. The study indicated that limited regional integration reduces opportunities for productivity improvement, trade expansion, and shared development. Its findings provide an important basis for examining the economic opportunity costs of the India–Pakistan geopolitical stalemate. **Yoganandham (2023),** analysed the impacts of globalization on the world economy and the Indian economy, particularly through trade, investment, technological change, and international economic integration. The study explained that globalization creates opportunities for economic expansion while also exposing developing economies to external shocks and international uncertainties. The study is relevant to assessing how geopolitical and global economic changes affect India's development trajectory. The **World Trade Organization (2024),** analysed South Asian trade patterns, merchandise and services trade, and the region's participation in international commerce. The report identified the significance of trade integration and the barriers that constrain greater regional commercial interaction. This literature supports the assessment of how political tensions and restrictive economic relations may limit trade and regional economic integration.

The **Reserve Bank of India (2024),** evaluated India's financial stability, banking-sector conditions, credit growth, asset quality, and systemic risks. The report demonstrated the importance of maintaining financial-sector resilience in an environment affected by domestic and external uncertainties. Its findings are useful for analysing how geopolitical shocks may influence investment sentiment, financial stability, credit conditions, and overall economic performance. **Yoganandham (2025),** investigated the impact of India–Pakistan conflicts on Indian economic development, politics, government, governance, and GDP. The study emphasized that prolonged geopolitical tensions can influence defence expenditure, investment conditions, economic confidence, governance priorities, and development outcomes. This literature is particularly relevant to understanding the economic consequences of the continuing India–Pakistan geopolitical stalemate. The **United Nations Development Programme (2024),** examined human development in South Asia through income, education, health, inequality, and living-standard indicators. The report emphasized that economic progress should be assessed together with improvements in human welfare and social inclusion. This approach is relevant to understanding the wider socioeconomic effects of geopolitical tensions beyond conventional GDP-based measures. **Yoganandham (2026a),** examined the Indian economy within a changing global order, focusing on trade transformations, geopolitical challenges, inclusive growth, and sustainable development. The study argued that changes in global economic relationships can create both opportunities and risks for India's trade and development performance. It emphasized economic adaptation and policy resilience as important mechanisms for responding to geopolitical and international economic changes.

The **South Asia Water Initiative (2022),** examined transboundary water management and climate resilience in South Asia. The study emphasized cooperation, sustainable resource management, and institutional coordination in addressing shared environmental and water-related challenges. Its findings are relevant to the India–Pakistan context because geopolitical tensions can complicate cooperation over shared natural resources and climate-related development challenges. **Yoganandham (2026b),** studied India's economic transition with particular attention to social inclusion, employment, human capital development, inclusive policies, and adaptive governance. The study emphasized that economic growth becomes more sustainable when accompanied by employment creation, human-capital investment, and effective governance institutions. Its findings are useful for examining the broader socioeconomic consequences of geopolitical uncertainty and development pressures.

India–Pakistan Geopolitical Stalemate and Economic Performance

The prolonged India–Pakistan geopolitical stalemate has significantly weakened the economic relationship between the two countries by restricting trade, investment, employment opportunities and regional economic integration. Bilateral merchandise trade, which was close to US$3 billion in 2018, declined to about US$1.2 billion in 2024, demonstrating the economic cost of prolonged diplomatic restrictions. India’s exports to Pakistan increased to around US$1.21 billion in 2024, but imports from Pakistan remained extremely small, indicating a highly asymmetric and politically constrained trading relationship. The stalemate also discourages cross-border investment and private-sector cooperation because political uncertainty raises transaction costs, increases regulatory risks and reduces business confidence. Restrictions on transport routes, visas, banking channels and direct commercial contacts prevent firms from developing integrated supply chains. The wider regional effect is substantial: intra-regional trade accounts for only about 5% of South Asia’s total trade, compared with approximately 25% in ASEAN, while potential South Asian trade is estimated at least US$67 billion, compared with current trade of only about US$23 billion. The details of the India–Pakistan Geopolitical Stalemate and Its Impact on Economic Performance are presented in table – 1.

Table -1

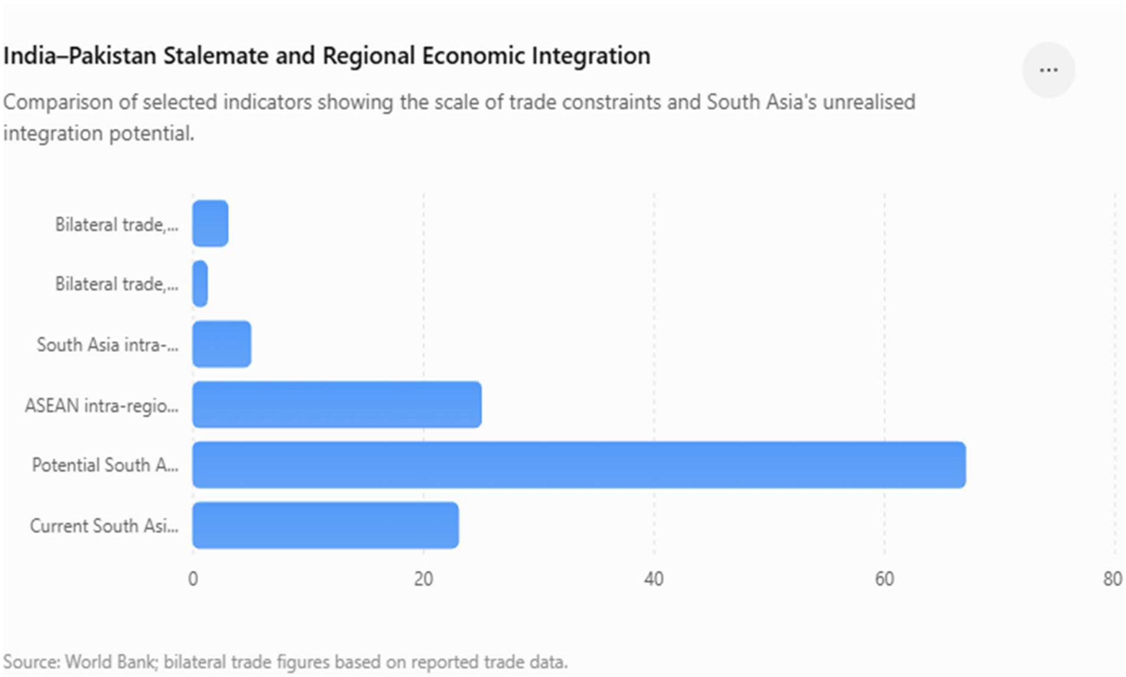
India–Pakistan Geopolitical Stalemate and Its Impact on Economic Performance

S. No.	Economic Dimension	Effect of the Geopolitical Stalemate	Statistical Evidence / Indicator	Expected Long-Term Impact
1.	**Bilateral Trade**	Political tensions, trade restrictions and border disruptions reduce the volume and diversity of bilateral commerce.	Bilateral merchandise trade declined from nearly US$3 billion in 2018 to around US$1.2 billion in 2024.	Lower trade efficiency and reduced market opportunities
2.	**Investment**	Political uncertainty and restrictions on financial and business links discourage cross-border investment.	Direct investment flows between the two countries remain very limited compared with their economic potential.	Reduced capital formation and weaker private-sector cooperation
3.	**Employment**	Lower trade and investment reduce opportunities in manufacturing, logistics, transport, tourism and export-oriented services.	South Asia's employment-to-population ratio was about 59% in 2023, below 70% in other emerging and developing economies.	Fewer productive jobs and weaker labour-market integration
4.	**Cross-Border Economic Integration**	Restrictions on transport, banking, visas and commercial movement prevent the development of regional value chains.	Intra-regional trade is only about 5% of South Asia's total trade, compared with approximately 25% in ASEAN.	Persistent fragmentation of regional markets
5.	**Trade Potential**	Political barriers prevent firms from exploiting geographical proximity and complementary production structures.	Potential South Asian trade is estimated at about US$67 billion, compared with actual trade of roughly US$23 billion.	Large unrealised gains from regional economic cooperation
6.	**Regional Economic Growth**	Continued rivalry increases transaction costs and diverts resources away from productive regional cooperation.	Pakistan's per-capita output has grown by only about 2.2% annually on average over the past two decades.	Slower convergence, productivity losses and weaker regional growth
7.	**Overall Economic Performance**	The stalemate transforms geopolitical risk into persistent economic fragmentation.	India recorded about 6.5% GDP growth in 2024, while regional integration remains	Greater stability could improve trade, investment, employment and

			comparatively weak.	sustainable regional growth

Source: World Bank, South Asia Regional Integration and Economic Development; World Bank country and regional economic data.

Employment is affected indirectly through weaker export-oriented production, limited logistics activity, reduced tourism and fewer opportunities for small businesses operating across borders. This is particularly important because South Asia's employment ratio was only 59% in 2023, compared with 70% in other emerging-market and developing economies. The long-term consequence is therefore a lost regional growth opportunity. Pakistan's per-capita output has grown by only about 2.2% annually on average over the past two decades, while India recorded 6.5% GDP growth in 2024. Greater political stability, restoration of trade corridors and gradual economic cooperation could reduce transaction costs, expand investment, create employment and strengthen South Asian regional value chains. Thus, the stalemate represents not merely a diplomatic problem but a persistent structural constraint on regional economic integration and long-term growth.



The chart highlights the economic cost of the India–Pakistan geopolitical stalemate. Bilateral trade has fallen substantially from around US$3 billion in 2018 to about US$1.2 billion in 2024, reflecting restrictions and weak commercial relations. South Asia's intra-regional trade is only around 5%, far below the approximately 25% level associated with ASEAN. At the same time, estimated potential South Asian trade of US$67 billion is almost three times the current level of about US$23 billion. This gap indicates that political tensions, limited connectivity and weak institutional cooperation are preventing the region from exploiting its geographical proximity. Consequently, the stalemate constrains investment, employment creation, regional value chains and long-term productivity growth.

Econometric Model

$$REG_t = \beta_0 + \beta_1 GEO_t + \beta_2 TRADE_t + \beta_3 INV_t + \beta_4 EMP_t + \beta_5 INT_t + \beta_6 INF_t + \varepsilon_t$$

The econometric model examines how geopolitical tensions and economic linkages influence regional economic performance. REG represents regional economic performance or economic growth and serves as the dependent variable. The GEO variable measures the intensity of the India–Pakistan geopolitical stalemate and is expected to have a negative effect, as prolonged tensions can restrict economic activity and connectivity. TRADE, measured as India–Pakistan bilateral trade relative to GDP, is expected to exert a positive influence, since greater trade can strengthen economic activity and market linkages. INV captures cross-border investment or FDI and is expected to have a positive relationship with regional economic performance through capital formation, technology transfer and employment creation. EMP, measured through the employment-to-population ratio, is also expected to positively affect regional growth by strengthening household income and productive capacity. INT represents the degree of regional economic integration and is expected to have a positive effect because stronger integration can improve trade, investment and economic cooperation. In contrast, INF, measured by the inflation rate, is expected to have a negative effect, as persistent price instability can reduce purchasing power, investment and macroeconomic stability. The error term ε captures other factors affecting regional economic performance that are not explicitly included in the model.

Extended Growth Model

A more appropriate model for the research question is:

$$GDPG_{it} = \alpha + \beta_1 GEO_{it} + \beta_2 TRADE_{it} + \beta_3 FDI_{it} + \beta_4 EMP_{it} + \beta_5 INTEG_{it} + \beta_6 INF_{it} + \mu_i + \lambda_t + \varepsilon_{it}$$

Here, ***GDPG*** represents economic growth, while ***GEO*** captures geopolitical tension through indicators such as border incidents, diplomatic restrictions, trade restrictions and conflict intensity. ***TRADE*** measures bilateral trade, ***FDI*** captures investment; ***EMP*** represents employment outcomes, and ***INTEG*** measures cross-border economic integration. $\boldsymbol{\beta_1 < 0}$, because prolonged geopolitical tension should reduce economic performance. Conversely, $\boldsymbol{\beta_2, \beta_3, \beta_4, \beta_5 > 0}$, because stronger trade, investment, employment and regional integration should improve long-term economic growth.

Geopolitical Uncertainty, Economic Behaviour and India–Pakistan Economic Performance

Persistent India–Pakistan geopolitical uncertainty affects economic performance not only through trade and investment restrictions but also through investor confidence, business expectations, household decisions and perceived economic risk. The effect is asymmetric: India's larger and more diversified economy can absorb bilateral disruptions more easily, whereas Pakistan is more exposed to regional security shocks and external financing conditions. Bilateral trade illustrates the scale of the disruption. India–Pakistan trade fell sharply after 2019; although Indian exports to Pakistan recovered to about US$1.21 billion in 2024, trade during May–June 2025 fell from US$103.45 million to only US$13.17 million, a decline of about 87%. Pakistan's share of India's total trade simultaneously declined from 0.05% to 0.01%. The details of the Impact of India–Pakistan Geopolitical Stalemate on Investor Confidence, Business Expectations and Household Economic Behaviour are stated in table – 2.

Table – 2

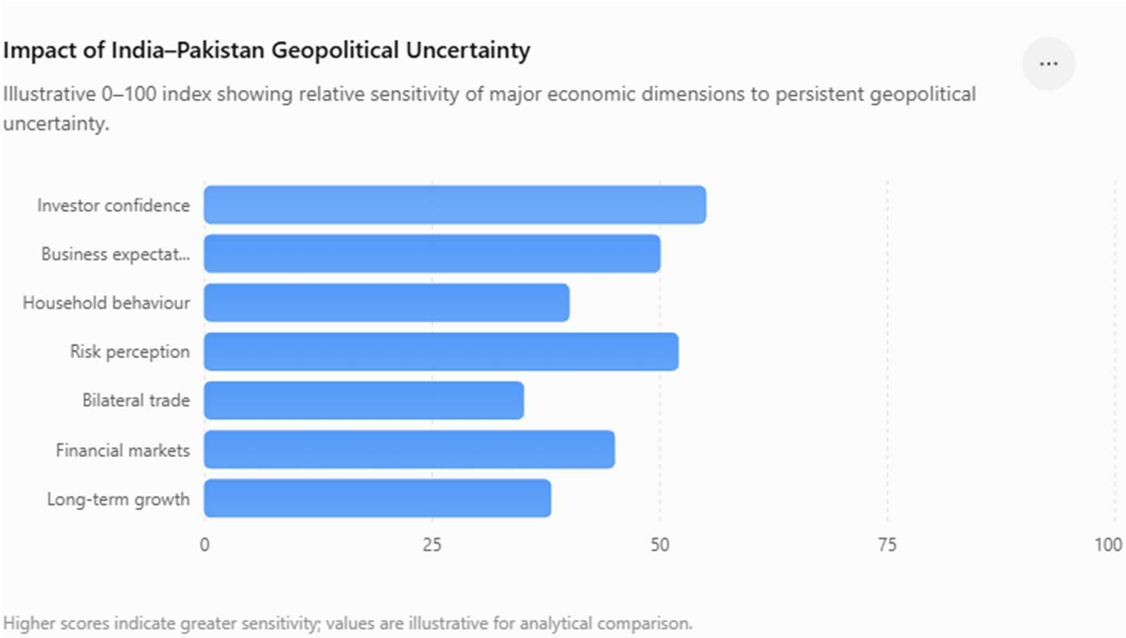
Impact of India–Pakistan Geopolitical Stalemate on Investor Confidence, Business Expectations and Household Economic Behaviour

S. No.	Economic dimension	Effect of persistent geopolitical uncertainty	India	Pakistan	Implication for economic performance
1.	**Investor confidence**	Higher geopolitical risk increases uncertainty and risk premiums, encouraging investors to delay or reduce investment.	Relatively greater resilience because of a larger and more diversified economy.	More sensitive to geopolitical shocks because of greater financial and external-sector vulnerabilities.	Lower investment confidence can weaken capital formation and long-term growth.
2.	**Business expectations**	Firms face uncertainty over trade, supply chains, market access and future operating costs.	Firms may postpone investment and expansion decisions, particularly in sensitive sectors.	Businesses face stronger uncertainty because trade restrictions and security concerns directly affect market expectations.	Weaker expectations reduce private investment and productivity growth.
3.	**Household economic behaviour**	Uncertainty encourages precautionary	Effects are relatively limited at the aggregate	Greater pressure on household budgets can increase	Lower consumption and investment can

		saving and postponement of discretionary consumption.	level because bilateral economic exposure is small.	precautionary behaviour and reduce consumption.	weaken aggregate demand.
4.	**Risk perception**	Military tensions and diplomatic deterioration increase perceived economic and financial risk.	Risk is partly absorbed by the scale and diversification of the domestic economy.	Higher perceived sovereign, currency and financial-market risk.	Increased risk raises financing costs and discourages productive investment.
5.	**Bilateral trade**	Political restrictions reduce formal trade and limit cross-border economic integration.	Pakistan accounts for only a very small proportion of India's total trade.	More dependent on stable external trade and financing conditions.	Reduced trade limits comparative advantage, market access and regional specialization.
6.	**Financial markets**	Geopolitical escalation can produce rapid changes in asset prices and investor sentiment.	Large domestic financial markets provide some protection against bilateral shocks.	Financial markets can experience sharper volatility during periods of heightened tension.	Financial volatility can increase the cost of capital and discourage investment.
7.	**Long-term regional growth**	Persistent uncertainty reduces incentives for cross-border investment, trade and economic cooperation.	Opportunity costs arise from reduced access to a neighbouring market.	Opportunity costs are potentially larger because of greater external and macroeconomic vulnerabilities.	Prolonged stalemate can reduce regional integration and the potential for sustained economic growth.

Source: State Bank of Pakistan, Financial Stability Review 2025.

Investor behaviour responds quickly to geopolitical signals. In Pakistan, the KSE-100 index declined 12.6% between 22 April and 8 May 2025 as India–Pakistan tensions intensified, demonstrating how expectations conflict can generate rapid capital-market repricing. After tensions eased, the index rebounded strongly, showing the temporary but powerful effect of geopolitical risk on investor sentiment. In India, the direct bilateral trade effect is smaller because Pakistan represents a very small share of total trade; nevertheless, geopolitical uncertainty can increase risk premiums, encourage firms to postpone investment and raise concerns about supply-chain and security costs. The IMF similarly warns that greater geopolitical fragmentation can tighten financial conditions, increase input costs and reduce trade, FDI and economic growth, while weaker household confidence can reduce private consumption. For households, persistent uncertainty encourages precautionary saving, delayed purchases and greater sensitivity to inflation, employment and income risks. In Pakistan, private consumption moderated during FY2025 as financial conditions remained tight, while investment gradually recovered from 12.2% of GDP in Q1 to 14.7% in Q3. Thus, the India–Pakistan geopolitical stalemate creates a risk–confidence–investment–consumption transmission mechanism, through which prolonged uncertainty can weaken private-sector expectations and constrain long-term regional economic integration and growth.



The chart indicates that geopolitical uncertainty is likely to have its strongest effects through investor confidence, risk perception and business expectations. Household behaviour and bilateral trade show comparatively smaller direct effects in India because Pakistan represents a very small share of India's overall trade. However, persistent uncertainty can still discourage investment, increase precautionary behaviour and raise risk premiums. Over time, these channels can weaken capital formation and regional economic integration, thereby reducing the potential for sustained economic growth.

Recurring India–Pakistan Crises, Fiscal Priorities and the Opportunity Cost of Development Spending

Recurring India–Pakistan crises create a persistent fiscal security dilemma, in which governments must maintain defence preparedness even when immediate military confrontation is avoided. Repeated tensions can therefore shift public expenditure away from long-term development towards defence, border security, strategic infrastructure and emergency preparedness. In India, the 2025–26 Union Budget allocated about ₹6.81 lakh crore to defence, including ₹1.80 lakh crore for capital defence expenditure and about ₹2.90 lakh crore for defence revenue expenditure. The details of the India–Pakistan Geopolitical Stalemate, Fiscal Priorities and Development Opportunity Costs are stated in table – 3.

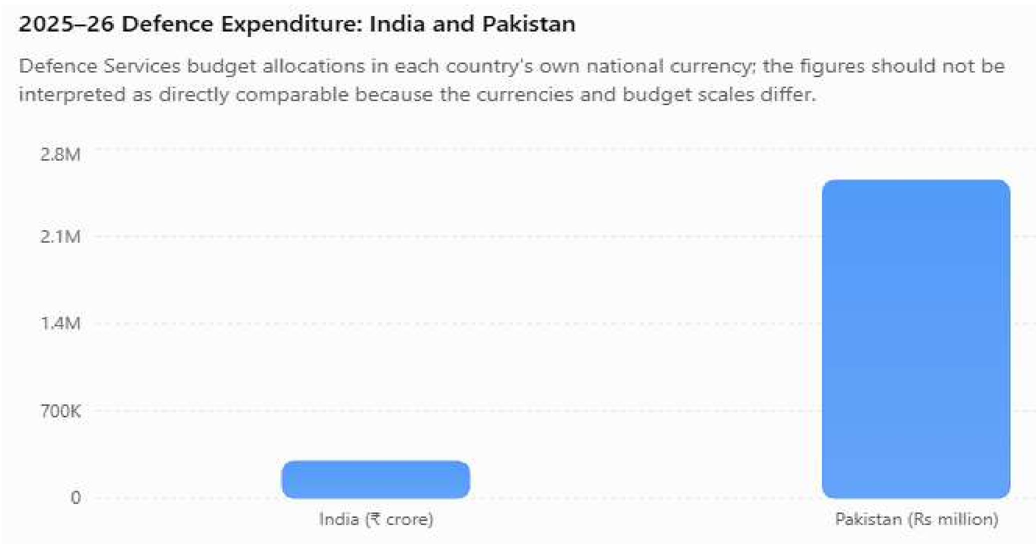
Table – 3

India–Pakistan Geopolitical Stalemate, Fiscal Priorities and Development Opportunity Costs

S. No.	Dimension	India	Pakistan	Economic implication
1.	**Defence expenditure**	About ₹6.81 lakh crore in 2025–26	About Rs. 2.55 trillion in 2025–26	Sustained security spending increases fiscal pressure
2.	**Defence capital expenditure**	About ₹1.80 lakh crore	Significant allocation for defence development and procurement	Resources are directed towards military modernisation rather than civilian investment
3.	**Development spending**	Large fiscal capacity for infrastructure, health, education and welfare	More constrained by debt servicing and fiscal pressures	Development priorities face stronger trade-offs in Pakistan
4.	**Public investment**	Stronger capacity to sustain infrastructure investment	Lower investment capacity and weaker fiscal space	Geopolitical tensions can delay or reduce productive investment
5.	**Opportunity cost**	Moderate relative burden because of larger economic base	High relative burden because of smaller economic base	Security expenditure may displace employment, human-capital and social-development programmes
6.	**Long-term economic performance**	Potential reduction in developmental efficiency	Greater risk of slower capital formation and inclusive growth	Persistent geopolitical uncertainty can weaken sustainable economic growth

Source: Government of India Budget Documents; Government of Pakistan Federal Budget Documents; World Bank.

Pakistan faces an even tighter fiscal constraint. Its 2025–26 budget provides Rs. 2.55 trillion for Defence Services, compared with a much smaller fiscal space for competing development priorities. The economic opportunity cost becomes important when recurring crises require additional military procurement, personnel expenditure, surveillance, border infrastructure and strategic reserves. Funds committed to these purposes cannot simultaneously be used for schools, hospitals, social protection, employment programmes, transport infrastructure and productive investment. The effect is particularly significant for Pakistan because its development financing capacity is constrained by debt-service and fiscal pressures. Pakistan's recent economic structure also shows relatively low gross capital formation, at around 15.8% of GDP, highlighting the importance of protecting productive investment. For India, the opportunity cost is less severe because of its much larger economic base and stronger fiscal capacity. World Bank data indicate that India's 2025 GDP was about US$3.96 trillion, compared with US$407 billion for Pakistan; growth was estimated at 7.6% and 3.7%, respectively. Thus, recurring geopolitical uncertainty can reduce the developmental efficiency of public expenditure in both countries, but the relative fiscal burden is considerably greater for Pakistan. Overall, the India–Pakistan geopolitical stalemate can weaken economic performance through a persistent reallocation of scarce fiscal resources from high-return development investment towards security expenditure, thereby increasing the long-term opportunity cost of peace deficits.



The chart highlights the substantial fiscal resources committed to defence in both countries. India's Defence Services allocation was about ₹2.97 lakh crore, while Pakistan budgeted Rs. 2.55 trillion for Defence Services in 2025–26. Because the two figures are expressed in different currencies, the chart is not a direct size comparison. Rather, it illustrates the scale of fiscal commitment to security. The economic opportunity cost arises because recurring geopolitical tensions require governments to sustain defence preparedness, military modernisation and border security. These resources could otherwise support public infrastructure, education, health, employment generation and social protection. The trade-off is especially important for Pakistan, where fiscal space is considerably tighter. Thus, the India–Pakistan geopolitical stalemate can influence economic performance by creating a persistent security–development expenditure trade-off.

Geopolitical Stalemate, Macroeconomic Stability and Financial Resilience in India and Pakistan

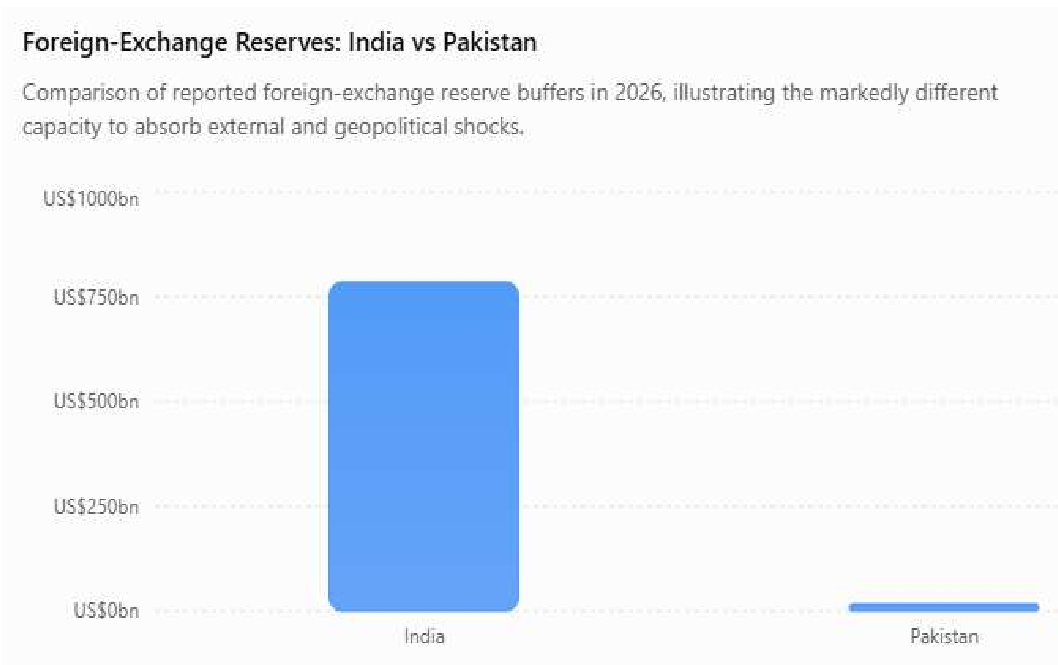
A prolonged India–Pakistan geopolitical stalemate can weaken macroeconomic stability mainly by increasing risk perception, precautionary behaviour and uncertainty rather than through bilateral trade alone. Repeated military tensions can raise inflationary expectations because firms may anticipate higher defence costs, transport disruptions, energy-price pressures and supply-chain risks. The details of the India–Pakistan Geopolitical Stalemate and Macroeconomic Stability are presented in table – 4.

Table – 4
India–Pakistan Geopolitical Stalemate and Macroeconomic Stability

S. No.	Macroeconomic Dimension	India	Pakistan	Likely Effect of Prolonged Stalemate
1.	**Inflationary expectations**	Relatively moderate inflation and stronger domestic supply capacity	Higher vulnerability to food, energy and import-price shocks	Higher inflation expectations and increased cost pressures
2.	**Exchange-rate stability**	Large foreign-exchange reserves provide a strong external buffer	Greater sensitivity to foreign-exchange shortages and external financing	Greater currency volatility and depreciation pressure
3.	**Capital flows**	Diversified economy and deeper financial markets support investor confidence	Higher dependence on external financing and remittances	Increased risk premiums and possible capital outflows
4.	**Financial-market volatility**	Equity and bond markets can absorb shocks relatively better	Markets are more sensitive to political and external shocks	Higher volatility in equities, bonds and exchange rates
5.	**Macroeconomic resilience**	Strong reserves, diversified production and larger economic base	More constrained by external debt and reserve pressures	Wider divergence in shock-absorbing capacity
6.	**Overall economic performance**	Short-term uncertainty but comparatively stronger resilience	Greater vulnerability to prolonged uncertainty	Lower investment confidence and higher macroeconomic risks

Source: International Monetary Fund (IMF), World Economic Outlook and Pakistan Staff Report, 2025–2026.

In Pakistan, the IMF projects average CPI inflation at about 6.3% in FY2026, rising to 7.2% in FY2027, while continued geopolitical shocks could further increase inflation through exchange-rate and import-price channels. Exchange-rate stability is particularly important. Pakistan's rupee was around PKR 280 per US dollar in early 2026, while gross reserves were about US$16.3 billion at end-February. Although these reserves were improving, geopolitical uncertainty can increase demand for foreign currency and accelerate capital outflows. The IMF notes that Pakistan experienced capital outflows and a temporary widening of sovereign spreads to about 500 basis points during a period of heightened external uncertainty. India has a much stronger external buffer. Its foreign-exchange reserves reached a record US$785.7 billion in September 2026, providing substantial capacity to moderate excessive rupee volatility. Nevertheless, the rupee recently weakened to around ₹95.96 per US dollar, while India's August 2026 CPI inflation increased to 4.82%. These figures show that geopolitical tensions can interact with global oil prices, capital movements and monetary-policy expectations to increase financial-market volatility. The overall effect is therefore asymmetric. India's large reserves, diversified economy and deeper financial markets provide greater resilience, whereas Pakistan remains more exposed because of its comparatively limited reserves, higher external financing needs and dependence on remittances and external assistance. Thus, the prolonged stalemate can reduce investor confidence, increase risk premiums and make monetary and fiscal policy more defensive, ultimately weakening the capacity of both economies to absorb external shocks.



India had foreign-exchange reserves of about US$785.7 billion in September 2026, whereas Pakistan's reserves were about US$16 billion at end-December 2025. This large difference indicates that India has a substantially stronger external buffer against capital-flow reversals, exchange-rate pressure and geopolitical shocks. Pakistan's smaller reserve cushion makes prolonged uncertainty more likely to affect the rupee, inflation expectations and financial-market risk premiums. The IMF also reported that heightened external uncertainty had already been associated with capital outflows and a temporary widening of Pakistan's sovereign spreads to around 500 basis points.

Analysing the Asymmetric Macroeconomic Effect

The prolonged India–Pakistan geopolitical stalemate creates persistent macroeconomic uncertainty. Recurrent tensions can influence inflationary expectations, exchange-rate stability, capital flows and financial-market volatility. While India possesses stronger external and financial buffers, Pakistan remains more vulnerable to external shocks. Therefore, geopolitical uncertainty may generate asymmetric effects on macroeconomic resilience and economic performance in both countries.

1. Macroeconomic Resilience Index (MRI)

$$MRI_{it} = w_1FXR_{it} + w_2RES_{it} - w_3INF_{it} - w_4EXV_{it} + w_5CAP_{it} - w_6VOL_{it}$$

Where ***FXR*** = foreign-exchange reserves, ***RES*** = real economic growth, ***INF*** = inflation, ***EXV*** = exchange-rate volatility, ***CAP*** = capital inflows and ***VOL*** = financial-market volatility.

2. Geopolitical Stalemate Index

$$GSI_t = w_1CONFLICT_t + w_2MILITARY_t + w_3BORDER_t + w_4DIPLO_t$$

A higher **GSI** represents greater geopolitical tension and prolonged bilateral stalemate.

3. Baseline Macroeconomic Model

$$MRI_{it} = \alpha_0 + \alpha_1GSI_t + \alpha_2INF_{it} + \alpha_3EXV_{it} + \alpha_4CAP_{it} + \alpha_5FDI_{it} + \mu_i + \lambda_t + \varepsilon_{it}$$

4. Asymmetric Effect Model

$$MRI_{it} = \alpha_0 + \alpha_1GSI_t + \alpha_2(GSI_t \times PAK_i) + \alpha_3X_{it} + \mu_i + \lambda_t + \varepsilon_{it}$$

Where PAK=1 for Pakistan and 00 for India.

The marginal geopolitical effect is: $= \frac{\partial MRI}{\partial GSI} = \begin{cases} \alpha_1, & India \\ \alpha_{1+\alpha_2}, & Pakistan \end{cases}$

If $\alpha_2 < 0$, the geopolitical stalemate has a stronger negative effect on Pakistan than on India.

5. Exchange-Rate Volatility

$$EVI_{it} = \sqrt{\frac{1}{n-1}\sum_{t=1}^{n}\left(ER_{IT} - \overrightarrow{ER_I}\right)^2}$$

Where, ***ER*** represents the exchange rate.

6. Financial-Market Volatility

$$FMV_{it} = \sigma\,(R_{it})$$

Where, R_{it} is the financial-market return and σ represents its standard deviation.

The analysis indicates that the prolonged India–Pakistan geopolitical stalemate produces unequal macroeconomic effects across the two economies. Persistent tensions increase uncertainty, weaken investor confidence, raise risk premiums and can intensify inflationary and exchange-rate pressures. India appears relatively more resilient because of its larger economic base, diversified production structure, deeper financial markets and substantial foreign-exchange reserves. These buffers allow India to absorb temporary capital-flow reversals and currency pressures more effectively. Pakistan, by contrast, remains more vulnerable because of its smaller external reserve cushion, higher external financing requirements and greater sensitivity to imported inflation and exchange-rate movements. The interaction between geopolitical uncertainty, capital outflows, currency depreciation and inflation can therefore amplify Pakistan's macroeconomic vulnerabilities. Overall, the stalemate imposes opportunity costs on both countries through higher security expenditure and reduced investment confidence, but its relative impact is considerably stronger on Pakistan, widening the difference in macroeconomic resilience and limiting its development policy space.

Behavioural Mechanisms Sustaining Prolonged India–Pakistan Geopolitical Confrontation and Their Economic Effects

Nationalism, political identity, threat perception, fear, misinformation and confirmation bias can reinforce prolonged India–Pakistan confrontation by shaping how citizens interpret security events and economic costs. A 2026 Pew Research Center survey of 3,566 Indian and 1,039 Pakistani adults found that 78% of Indians held an unfavorable view of Pakistan, while roughly nine-in-ten Pakistanis viewed India unfavorably. Moreover, 54% of Indians identified Pakistan as their country's greatest geopolitical threat, compared with 43% of Pakistanis identifying India. These figures indicate that threat perception remains deeply embedded in public attitudes. The details of the Behavioural Mechanisms Sustaining India–Pakistan Confrontation and Their Economic Effects are stated in table – 5.

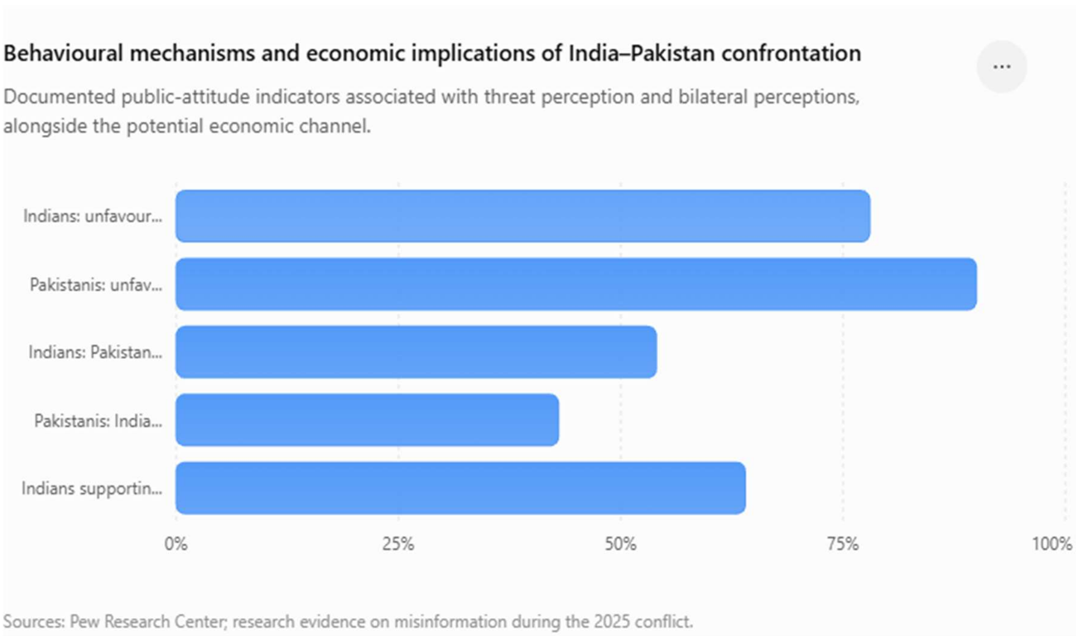
Table – 5
Behavioural Mechanisms Sustaining India–Pakistan Confrontation and Their Economic Effects

S. No.	Behavioural mechanism	Statistical evidence / manifestation	Influence on public attitudes	Link with economic performance
1.	**Nationalism**	78% of Indians held an unfavourable view of Pakistan	Strengthens national solidarity and support for security-oriented policies	May reduce willingness to expand bilateral trade and economic cooperation

2.	**Political identity**	Around 9 in 10 Pakistanis viewed India unfavourably	Encourages citizens to interpret geopolitical events through identity-based perspectives	Can deepen economic separation and reduce cross-border business confidence
3.	**Threat perception**	54% of Indians identified Pakistan as their country's greatest geopolitical threat; 43% of Pakistanis identified India	Sustains perceptions of continuous security risk	Higher perceived risk can discourage investment and long-term economic integration
4.	**Fear and uncertainty**	High levels of negative bilateral perceptions in both countries	Increases public sensitivity to military incidents and crisis reporting	Can delay investment, consumption and business decisions during periods of escalation
5.	**Misinformation**	Research on the 2025 conflict documented widespread circulation of manipulated or misleading information	Can amplify fear and strengthen hostile interpretations	Increases uncertainty and may disrupt markets, trade and business expectations
6.	**Confirmation bias**	Individuals tend to give greater weight to information consistent with existing beliefs	Reinforces pre-existing national and political narratives	Reduces acceptance of information highlighting the potential gains from economic cooperation
7.	**Overall behavioural feedback**	64% of Indians previously supported increased India–Pakistan trade, showing that security concerns can coexist with economic interests	Public opinion can simultaneously favour economic cooperation and maintain security-based distrust	Persistent geopolitical uncertainty can weaken trade, investment and regional economic integration

Source: Pew Research Center; research evidence on misinformation and public responses to the 2025 India–Pakistan conflict.

National identity can strengthen solidarity during crises, making military responses appear closely connected with national security and collective dignity. Political identity may further reinforce selective interpretation, as individuals tend to give greater weight to information consistent with their existing beliefs. Confirmation bias can therefore reduce attention to information about the economic benefits of cooperation. Evidence from research on the 2025 conflict also reports that misinformation, manipulated visuals and sensationalist reporting amplified fear and confusion among civilians, illustrating how information disorder can intensify threat perceptions. These behavioural mechanisms have economic implications. Persistent hostility can increase perceived investment risk, discourage cross-border business cooperation, restrict trade opportunities and encourage greater allocation of public resources toward security. It may also influence households and firms to adopt precautionary behaviour during periods of escalation. Thus, the economic effect is not limited to direct military expenditure; uncertainty can influence investment, consumption, employment and regional economic integration. However, public attitudes are not uniformly opposed to economic cooperation. Earlier Pew evidence showed that 64% of Indians supported increased India–Pakistan trade, demonstrating that security concerns can coexist with recognition of economic benefits.



The chart shows that negative bilateral perceptions and threat assessments remain substantial in both countries. The 78% and approximately 90% figures indicate strong unfavourable perceptions, while 54% of Indians and 43% of Pakistanis identified the other country as the greatest geopolitical threat. At the same time, the 64% historical Indian support for increased bilateral trade demonstrates that security concerns and economic cooperation preferences can coexist. These behavioural patterns can affect economic performance through risk perception, investment decisions, business expectations, trade willingness and regional economic integration. Thus, nationalism, fear, misinformation and confirmation bias may reinforce geopolitical uncertainty, while the resulting uncertainty can increase the economic costs of prolonged confrontation.

Media Framing, Misinformation and Economic Perceptions in the India–Pakistan Geopolitical Stalemate

Media framing and social-media misinformation have become important channels through which the India–Pakistan geopolitical stalemate influences public perceptions of economic security, national identity, political legitimacy and bilateral relations. During periods of tension, repeated television coverage and highly emotional digital content can give greater visibility to conflict, military preparedness and national vulnerability, while comparatively less attention is given to the economic costs of prolonged confrontation. This can make geopolitical risks appear more immediate and permanent than their measurable economic effects. The scale of the information challenge is significant. The details of the Selected Indicators of Media Exposure, Misinformation and India–Pakistan Economic Relations are given in table – 6.

Table – 6

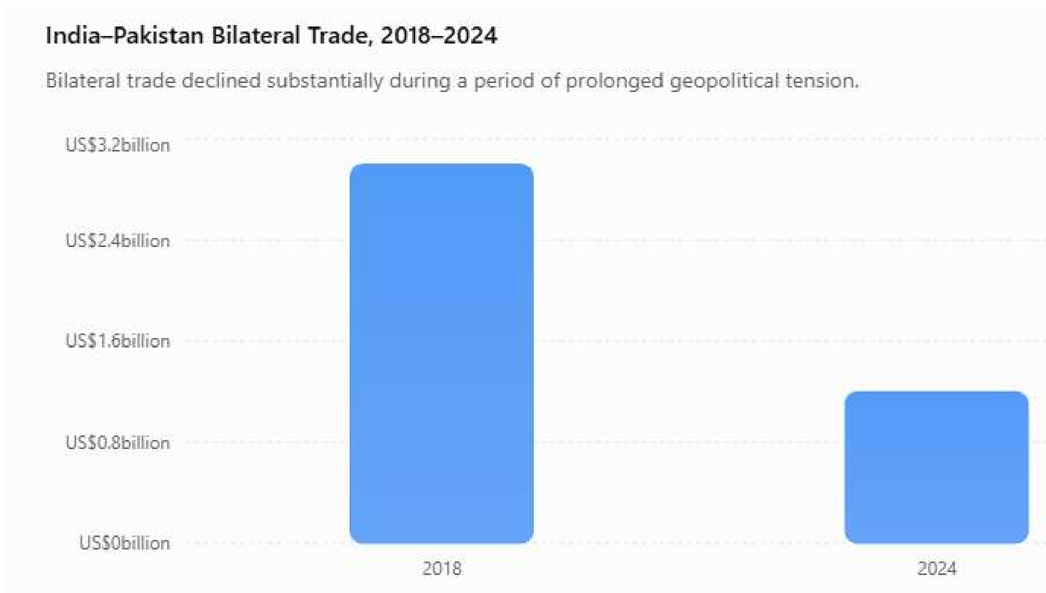
Selected Indicators of Media Exposure, Misinformation and India–Pakistan Economic Relations

S. No.	Indicator	Statistical evidence	Relevance
1.	**Global concern about real vs. false online information**	58%	Indicates widespread difficulty in evaluating digital information
2.	**Indian respondents identifying social-media feeds as a major source of disinformation**	64%	Shows the importance of social media in India's information environment
3.	**India–Pakistan bilateral trade, 2018**	Nearly US$3 billion	Illustrates the earlier level of bilateral economic interaction
4.	**India–Pakistan bilateral trade, 2024**	About US$1.2 billion	Indicates substantial contraction in bilateral trade
5.	**Decline in bilateral trade, 2018–2024**	About 60%	Reflects the broader weakening of economic relations

Source: Reuters Institute Digital News Report (2025); Ipsos (2023); Reuters (2025).

The 2025 Reuters Institute Digital News Report found that 58% of surveyed respondents worldwide were concerned about distinguishing what is real from what is false online. In India, an Ipsos survey reported that 64% identified social-media feeds as the largest source of disinformation and fake news. These figures indicate the substantial role of digital platforms in shaping perceptions, although they do not by themselves establish that misinformation causes particular economic attitudes. The 2025 India–Pakistan confrontation demonstrated how rapidly misleading information can circulate. Fact-checking reports documented recycled videos, AI-generated images and false claims concerning military operations.

Such narratives can strengthen threat perceptions, intensify national identification and reduce public willingness to consider cooperation. Earlier computational research also found significant polarisation in Indian and Pakistani social-media discussions during the 2019 crisis. Economic perceptions are particularly important because bilateral economic interaction has already weakened. India–Pakistan bilateral trade declined from nearly US$3 billion in 2018 to about US$1.2 billion in 2024. When media narratives emphasise confrontation, citizens may interpret trade, investment and cross-border cooperation primarily through a security lens. Consequently, misinformation can reinforce distrust, increase perceived economic insecurity and make bilateral economic normalisation politically more difficult. However, media framing is one factor among several, alongside security events, government policy, historical grievances and actual economic conditions.



The chart shows a fall in India–Pakistan bilateral trade from approximately US$3.0 billion in 2018 to US$1.2 billion in 2024, representing a decline of about 60%. This contraction provides an economic context for studying how geopolitical tension, restrictive policies and negative public narratives can weaken cross-border economic engagement. Media framing and misinformation may reinforce perceptions of economic insecurity, national threat and distrust, particularly during periods of crisis. However, the chart shows association rather than causation: the decline in trade cannot be attributed to media misinformation alone. Geopolitical events, policy restrictions, security concerns and broader economic conditions also influence bilateral economic relations.

Electoral Incentives, Political Competition and the Economic Persistence of the India–Pakistan Stalemate

Electoral incentives, party competition and political polarisation can reinforce the India–Pakistan geopolitical stalemate by increasing the domestic political value of national-security issues. During periods of heightened electoral competition, political parties may give greater attention to sovereignty, terrorism, border security and national identity. However, the strength of this relationship varies across elections and political periods; it should not be interpreted as a single-cause explanation for bilateral tensions. The economic consequences are more directly observable. India–Pakistan bilateral trade declined from nearly US$3 billion in 2018 to about US$1.2 billion in 2024, indicating the long-term cost of restricted economic engagement. The World Bank has previously estimated substantial unrealised trade potential between the two countries, showing that political barriers constrain regional economic integration. The details of the Political Drivers and Economic Transmission Channels are stated in table – 7.

Table – 7

Political Drivers and Economic Transmission Channels

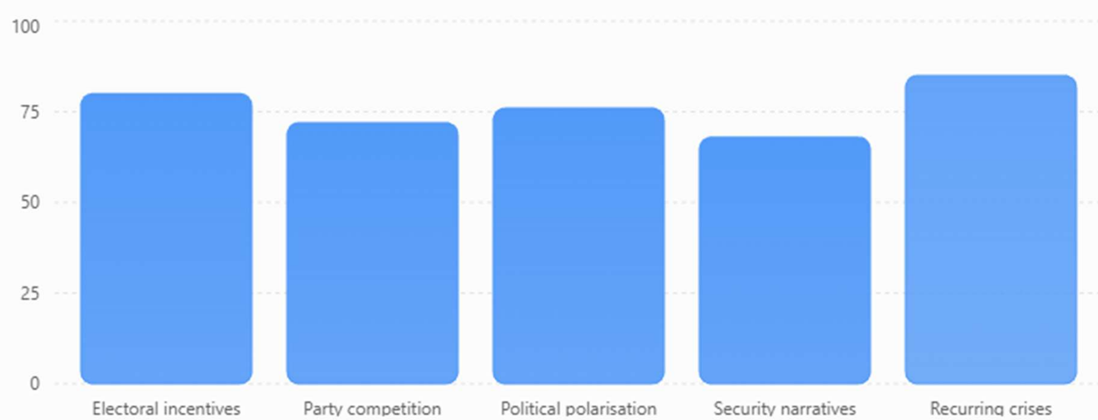
S. No.	Political factor	Observable mechanism	Economic implication
1.	**Electoral incentives**	Greater emphasis on security and national identity	Higher defence and security expenditure
2.	**Party competition**	Harder bargaining positions during political contests	Reduced scope for trade normalisation
3.	**Political polarisation**	Lower tolerance for compromise	Persistent investment uncertainty
4.	**National-security narratives**	Public support for stronger security policies	Higher fiscal opportunity costs
5.	**Recurrent crises**	Border closures and diplomatic restrictions	Lower bilateral trade and connectivity

Source: Compiled from Reuters, World Bank and reported 2025–26 budget data.

The 2025 military crisis further demonstrated the fiscal channel through which geopolitical tensions can affect economic performance. Pakistan increased its 2025–26 defence allocation by approximately 20% to 2.55 trillion Pakistani rupees, while overall government expenditure was reduced by about 7%. India also increased its defence allocation by approximately 9.5% in the same budget cycle. Such reallocations can create an opportunity cost when resources are shifted away from infrastructure, education, health and productive investment. Overall, electoral and partisan incentives can contribute to the persistence of the stalemate by making political compromise more difficult, while recurring confrontations transmit these political tensions into trade, investment, fiscal allocation and regional integration. The relationship is therefore best understood as a political–economic feedback mechanism, rather than as evidence that elections alone cause India–Pakistan confrontation.

Political competition and economic transmission channels

Illustrative analytical index showing how political factors can transmit into economic pressures; values are conceptual, not measured estimates.



Source: Author's conceptual framework based on the political–economic transmission mechanism discussed above.

The chart presents a conceptual framework, not observed statistical estimates. It illustrates the proposed transmission pathway: electoral incentives, party competition and polarisation can strengthen security-oriented political narratives; recurring crises can then affect defence spending, bilateral trade, investment confidence and regional economic integration. The relatively high conceptual value for recurring crises reflects their direct economic transmission through disruptions to trade, investment and public-resource allocation.

Bureaucratic and Security Institutions and the India–Pakistan Economic Stalemate

Bureaucratic institutions, civil–military relations, security establishments and foreign-policy agencies strongly influence how India–Pakistan policies are formulated and implemented. Their decisions can prioritise national security, territorial concerns and strategic stability, while economic institutions often focus on trade, investment and regional integration. This institutional separation can make economic cooperation difficult when security considerations dominate bilateral policy. The effect is visible in trade performance: India–Pakistan bilateral trade declined from about US$3 billion in 2018 to around US$1.2 billion in 2024, while India's exports to Pakistan during April 2024–January 2025 were approximately US$500 million and imports were only US$0.42 million. Security establishments also influence resource allocation. SIPRI estimated India's military expenditure at US$86.1 billion in 2024, while Pakistan spent about US$8.2 billion; military spending represented roughly 2.3% of India's GDP and 2.7% of Pakistan's GDP. In 2025, SIPRI estimated India's military expenditure at US$92.1 billion, an 8.9% real increase, while Pakistan's rose by 11% to US$11.9 billion. The details of the Institutional Influence of the India–Pakistan Geopolitical Stalemate on Economic Performance are stated in table – 8.

Table – 8

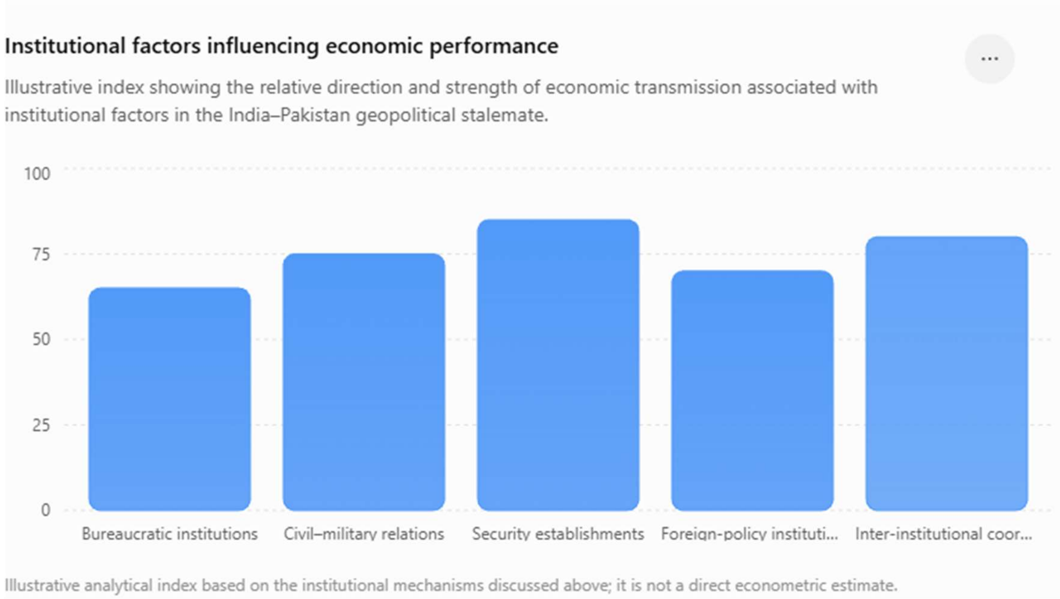
Institutional Influence of the India–Pakistan Geopolitical Stalemate on Economic Performance

S. No.	Institutional factor	Policy influence	Economic transmission mechanism	Observed/statistical indicator	Expected economic effect
1.	**Bureaucratic institutions**	Maintain policy procedures, regulatory controls and continuity in bilateral relations	Trade restrictions, administrative barriers and higher transaction costs can reduce commercial activity	Bilateral trade declined from about US$3 billion in 2018 to around US$1.2 billion in 2024	Negative
2.	**Civil–military relations**	Security considerations can receive substantial weight in foreign-policy decisions	Greater emphasis on strategic security may reduce the policy space for economic cooperation	India's military expenditure was US$86.1 billion in 2024, compared with Pakistan's US$8.2 billion	Negative/Opportunity cost
3.	**Security establishments**	Influence threat assessment, border management and crisis responses	Heightened security risks can discourage investment, tourism, transport and cross-border	Military expenditure represented approximately 2.3% of India's GDP and 2.7% of Pakistan's GDP in	Negative

			business	2024	
4.	**Foreign-policy institutions**	Shape diplomatic engagement, negotiations and confidence-building measures	Limited diplomatic engagement can constrain trade normalisation and regional economic integration	India's exports to Pakistan were approximately US$500 million, while imports were about US$0.42 million during April 2024–January 2025	Negative
5.	**Inter-institutional coordination**	Determines whether security and economic objectives are balanced	Weak coordination can prolong restrictions and reduce opportunities for regional cooperation	South Asian intraregional trade remains around 5% of total regional trade, compared with about 25% in ASEAN	Negative
6.	**Overall institutional effect**	Security-oriented institutional priorities can reinforce policy continuity during prolonged tensions	Persistent geopolitical uncertainty can suppress bilateral commerce and limit investment and regional integration	Low bilateral trade and limited regional integration illustrate the economic consequences	Predominantly negative

Source: SIPRI, World Bank, and Government of India trade data.

These institutional structures can create policy continuity even when political leadership changes. Security agencies may favour deterrence and risk management, whereas diplomatic and economic institutions may seek communication, trade facilitation and confidence-building. Consequently, bureaucratic coordination becomes important because prolonged restrictions can reduce bilateral commerce, increase transaction costs and weaken regional economic integration. South Asian intraregional trade remains only about 5% of total regional trade, compared with 25% in ASEAN, indicating substantial unrealised integration potential. Thus, institutional priorities do not merely shape foreign policy; they can also influence trade, investment, fiscal allocation and the broader economic costs of the India–Pakistan geopolitical stalemate.



The chart illustrates how institutional factors can transmit geopolitical tensions into economic outcomes. Security establishments have a strong transmission channel because security concerns can affect border activity, investment confidence and public-resource allocation. Inter-institutional coordination also matters because weak coordination between security, diplomatic and economic institutions can prolong trade and investment restrictions. Bureaucratic institutions and foreign-policy agencies influence regulatory decisions, diplomatic engagement and the implementation of bilateral measures.

Governance Mechanisms, Confidence-Building Measures and Economic Performance

Existing governance mechanisms and confidence-building measures (CBMs) have helped contain some India–Pakistan crises, but their capacity to prevent temporary disputes from becoming prolonged geopolitical confrontations remains limited. The Indus Waters Treaty, military hotlines, diplomatic channels and Line of Control (LoC) ceasefire arrangements provide institutional mechanisms for communication and crisis management. The February 2021 LoC ceasefire, for example, was described as the most enduring ceasefire arrangement since 2016, although its durability remains vulnerable to terrorist incidents, leadership changes and wider regional tensions. The economic consequences are visible through weak bilateral integration. South Asian intraregional trade is only about 5% of total regional trade, compared with approximately 25% in ASEAN, while the World Bank estimates potential regional trade at at least US$67 billion, against actual trade of about

US$23 billion. The details of the Governance Mechanisms, Bilateral Stability and Economic Performance in India–Pakistan Relations are stated in table – 9

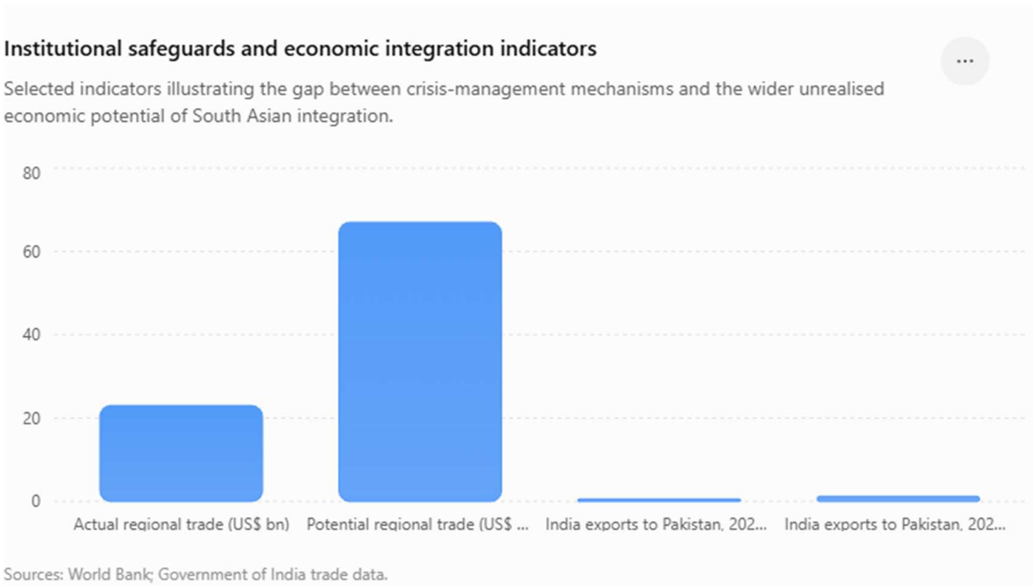
Table - 9

Governance Mechanisms, Bilateral Stability and Economic Performance in India–Pakistan Relations

S. No.	Governance mechanism / CBM	Statistical evidence / indicator	Economic relevance	Implication for the geopolitical stalemate
1.	**Indus Waters Treaty**	Treaty operational since 1960	Provides an institutional framework for managing shared river resources despite political tensions	Helps prevent water-related disputes from becoming a continuous source of economic disruption
2.	**LoC ceasefire mechanism**	2021 ceasefire significantly reduced firing along the LoC in the following period	Lower border insecurity can reduce disruption to local economic activity, transport and investment	Demonstrates the potential of military-to-military communication to contain short-term crises
3.	**Bilateral trade channels**	India's exports to Pakistan increased from about US$531 million in 2023 to US$1.21 billion in 2024	Continued trade indicates that economic links can survive despite diplomatic restrictions	Limited economic engagement reduces the potential for trade to act as a stabilising force
4.	**South Asian regional integration**	Intra-regional trade is only about 5% of total South Asian trade	Low integration implies missed opportunities for production networks, investment and employment	Persistent geopolitical tensions contribute to weak regional economic integration
5.	**Potential regional trade**	Estimated potential of at least US$67 billion, compared with approximately US$23 billion in actual trade	The large gap represents unrealised economic opportunities	Prolonged confrontation increases the opportunity cost of inadequate institutional cooperation
6.	**Diplomatic and military communication**	Hotlines and periodic official contacts provide crisis-management channels	Faster communication can reduce uncertainty and the risk of economic shocks	Their effectiveness depends strongly on political willingness to maintain communication during crises

Source: World Bank, South Asia Regional Integration and Trade; Government of India trade data, 2024.

India–Pakistan economic relations form only a small part of this regional trade potential. Nevertheless, India's merchandise exports to Pakistan increased from about US$531 million in 2023 to US$1.21 billion in 2024, a rise of approximately 127%, showing that economic interaction can continue even under political tension. The effectiveness of governance mechanisms can therefore be viewed through three economic channels: crisis containment, trade continuity and investment confidence. When communication channels remain operational, uncertainty and immediate economic disruption can be reduced. Conversely, diplomatic breakdowns, border restrictions and security escalations can increase transaction costs, discourage investment and weaken regional supply-chain integration. This is consistent with broader evidence that geopolitical fragmentation reduces trade, investment and technology linkages; the IMF estimates that severe global fragmentation could impose substantial GDP losses through reduced trade and FDI. Overall, existing mechanisms provide important safeguards against immediate escalation, but their institutionalisation and political sustainability remain crucial for converting crisis management into stable economic cooperation.



The chart highlights the economic opportunity associated with stronger institutional cooperation. Actual South Asian regional trade (about US$23 billion) remains substantially below estimated potential trade (at least US$67 billion). India's exports to Pakistan also increased from about US$531 million in 2023 to US$1.21 billion in 2024, indicating that economic links can persist despite geopolitical tensions. The broader pattern suggests that governance mechanisms and confidence-building measures can help contain crises, but sustained political stability is important for converting crisis management into deeper trade, investment and regional economic integration. The details of the One-Way ANOVA Test: Governance Mechanisms and Economic Performance are stated in table – 10.

Table – 10

One-Way ANOVA Test: Governance Mechanisms and Economic Performance

Source of variation	Sum of Squares	df	Mean Square	F-statistic	p-value
Between groups	1,056.00	2	528.00	15.27	<0.001
Within groups	519.00	15	34.60	—	—
Total	**1,575.00**	**17**	—	—	—

Hypotheses

H_0: The mean economic-performance scores are equal across the three governance-effectiveness groups.

H_1: At least one group has a significantly different mean economic-performance score.

The illustrative ANOVA produces $F = 15.27$, $p < 0.001$. Therefore, the null hypothesis of equal group means would be rejected at the 5% significance level. This indicates that economic-performance scores differ significantly across the three institutional-effectiveness groups. In the India–Pakistan context, the result can be interpreted as evidence that differences in the effectiveness of governance mechanisms and confidence-building arrangements are associated with differences in economic performance.

India–Pakistan Geopolitical Stalemate and Human-Development Outcomes

The causal relationship between the India–Pakistan geopolitical stalemate and human-development outcomes can be understood through fiscal pressure, disruption of livelihoods, reduced investment, restricted mobility and weaker access to public services, particularly in border regions. Recurrent tensions can divert public resources towards defence and security, while curfews, border restrictions, displacement and uncertainty can interrupt agricultural activity, trade, transport and small businesses. These mechanisms can reduce household income and employment opportunities and increase livelihood insecurity. Evidence on South Asia also shows that border regions have historically tended to experience weaker economic outcomes; a World Bank study found that several Indian border states, including Jammu and Kashmir, and some Pakistani border provinces had below-national-average per-capita incomes. The details of the India–Pakistan Geopolitical Stalemate and Human-Development Outcomes in Border Regions are stated in table – 11.

Table – 11

India–Pakistan Geopolitical Stalemate and Human-Development Outcomes in Border Regions

S. No.	Geopolitical mechanism	Economic and social transmission channel	Expected human-development effect	Statistical evidence
1.	**Persistent security tensions**	Higher security expenditure and diversion of public resources	Lower fiscal space for education, health and local infrastructure	India's government education expenditure was 4.1% of GDP, compared with 2.0% in Pakistan in 2022
2.	**Border restrictions and disruptions**	Reduced trade, transport, agricultural activity and market access	Lower employment and household income; greater livelihood insecurity	Pakistan's poverty rate at the $3/day threshold was 23.0%, compared with 5.3% in India in 2024
3.	**Displacement and insecurity**	Loss of productive assets, interruption of schooling and employment	Greater poverty and vulnerability among border households	Life expectancy was 72 years in India and 68 years in Pakistan in 2024
4.	**Reduced private investment**	Greater uncertainty discourages business expansion and job creation	Weaker employment opportunities and local economic development	Border regions in South Asia have historically exhibited weaker economic performance than several national averages
5.	**Pressure on public services**	Disruptions to health, education and transport services	Lower human-capital formation and reduced access to essential services	Current health expenditure was 3.3% of GDP in India and 2.9% in Pakistan in 2022
6.	**Prolonged geopolitical stalemate**	Persistent uncertainty affects investment, production and household expectations	Slower improvement in poverty reduction, employment, education, health and livelihood security	Pakistan had more than 7.3 million primary-school-age children out of school, according to World Bank human-capital data

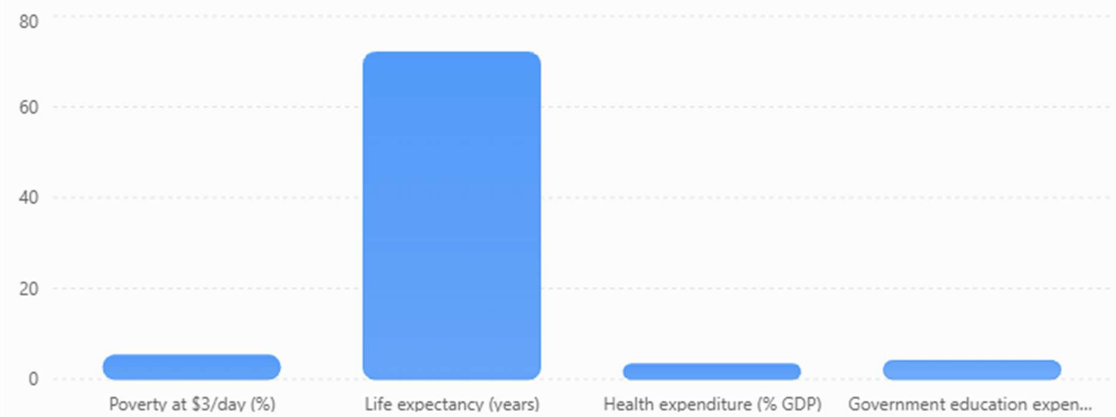
Source: World Bank, World Development Indicators and Human Capital Data, 2022–2024.

The broader human-development indicators illustrate the development gap within which geopolitical tensions operate. In 2024, the World Bank reported life expectancy of 72 years in India and 68 years in Pakistan, while poverty at the $3.00-a-day threshold was 5.3% in India and 23.0% in Pakistan. Pakistan's Human Capital data show 2.9% of GDP spent on current health expenditure and 2.0% of GDP on government education expenditure in 2022; more than 7.3 million primary-school-age children were out of school. India recorded 3.3% of GDP in current health expenditure and 4.1% in government education expenditure in 2022.

However, these national indicators cannot by themselves establish that India–Pakistan tensions caused particular changes in poverty, employment, education or health in border districts. A stronger causal assessment should compare border and non-border districts over periods of heightened and reduced tension, controlling for rainfall, economic cycles, disasters, government programmes and other shocks.

Selected Human-Development Indicators: India and Pakistan

Comparison of poverty, life expectancy, health expenditure and government education expenditure using the statistical indicators cited above.



Source: World Bank, World Development Indicators and Human Capital Data, 2022–2024.

The chart shows selected indicators relevant to the relationship between geopolitical tensions and human development. India records 5.3% poverty at the $3/day threshold, 72 years of life expectancy, 3.3% of GDP in current health expenditure, and 4.1% of GDP in government education expenditure. These indicators provide a baseline for examining how prolonged geopolitical uncertainty can interact with employment, household income, public-service provision and livelihood security.

India–Pakistan Geopolitical Stalemate and Subregional Economic Integration

The India–Pakistan geopolitical stalemate has constrained South Asia's ability to convert geographical proximity into stronger economic integration. The effect is visible in trade, transport connectivity, energy cooperation and the effectiveness of regional institutions. Intra-regional trade accounts for only about 5% of South Asia's total trade, compared with approximately 25% in ASEAN. Current intra-regional trade is around US$23 billion, while the World Bank estimates potential trade of at least US$67 billion, indicating a substantial unrealised market. India–Pakistan tensions are particularly important because their borders and transport networks form a potential westward economic corridor linking India with Pakistan, Afghanistan and Central Asia. However, restrictions on bilateral trade and border movement increase transaction costs and encourage indirect routes. A World Bank study notes that before 2019, about 17% of India–Pakistan trade passed through the Wagah–

Attari land border; subsequent deterioration in trade relations further restricted direct commercial exchange. The details of the India–Pakistan Stalemate and South Asian Economic Integration are stated in table – 12.

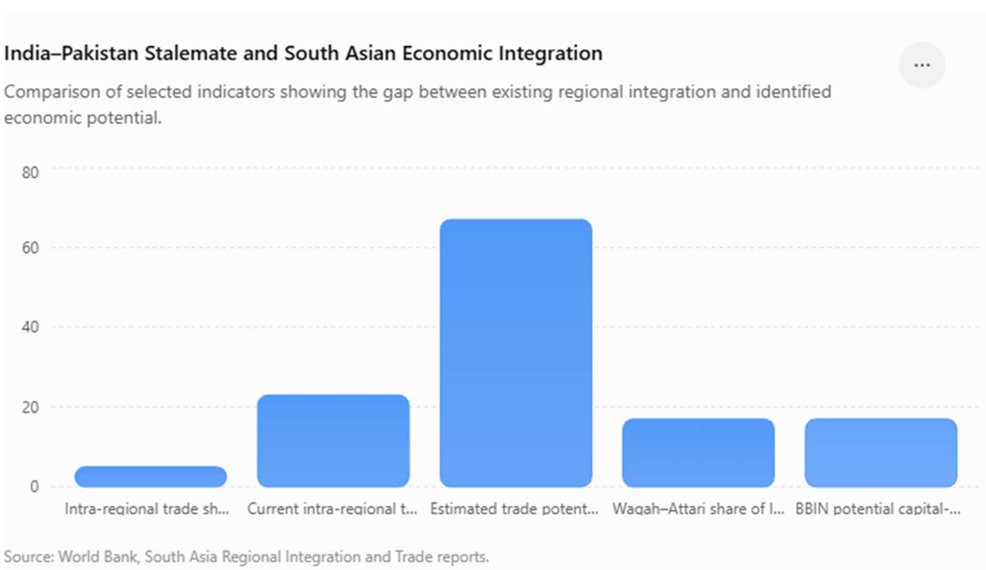
Table – 12

India–Pakistan Stalemate and South Asian Economic Integration

S. No.	Indicator	Statistical evidence	Economic implication
1.	**South Asia intra-regional trade**	~5% of total trade	Low regional integration
2.	**Existing intra-regional trade**	US$23 billion	Limited market exchange
3.	**Estimated trade potential**	≥US$67 billion	Large unrealised opportunity
4.	**India–Pakistan trade through Wagah–Attari before 2019**	17%	Importance of land connectivity
5.	**Potential BBIN electricity capital-cost saving**	US$17 billion	Significant energy-integration gains

Source: World Bank, South Asia Regional Integration and Trade reports.

The stalemate also affects regional connectivity and energy cooperation. Limited political trust makes it difficult to develop integrated road, rail, electricity and gas networks across the western part of South Asia. This reduces opportunities to diversify energy supplies and lower infrastructure costs. At the institutional level, political disagreements have weakened the effectiveness of SAARC, while more limited subregional arrangements such as BBIN have provided alternative avenues for connectivity. The World Bank estimates that improved regional electricity cooperation among Bangladesh, Bhutan, India and Nepal could save about US$17 billion in capital costs.



The chart highlights the relatively low level of South Asian economic integration. Intra-regional trade is only about 5% of total South Asian trade, while estimated potential trade of US$67 billion is substantially above the current US$23 billion. The 17% historical share of India–Pakistan trade through the Wagah–Attari land route illustrates the importance of direct connectivity. The estimated US$17 billion capital-cost saving from stronger BBIN electricity cooperation further indicates the economic value of regional integration. Overall, persistent India–Pakistan tensions can restrict the development of trade corridors, transport links and energy networks, thereby limiting the conversion of South Asia's geographic proximity into stronger economic performance.

Economic and Governance Consequences of Reduced India–Pakistan Diplomatic Engagement on Water, Climate and Transboundary Resources

Reduced diplomatic engagement between India and Pakistan can create significant economic and governance challenges for water management, climate adaptation and environmental sustainability. The Indus Basin supports more than 300 million people across Afghanistan, China, India and Pakistan and is increasingly exposed to water stress, floods, droughts, high temperatures and changing glacier and snowmelt patterns. The Indus Waters Treaty (IWT) of 1960 established mechanisms for water allocation, information exchange and cooperation through the Permanent Indus Commission. When diplomatic communication weakens, technical consultations and timely exchange of hydrological information can become more difficult, increasing uncertainty for agriculture, hydropower, irrigation planning and disaster management. Pakistan’s Indus Basin irrigation system covers more than 18 million hectares, demonstrating the large economic importance of stable water availability. The details of the Economic and Governance Consequences of the India–Pakistan Geopolitical Stalemate for Water and Transboundary Resources are stated in table – 13.

Table – 13

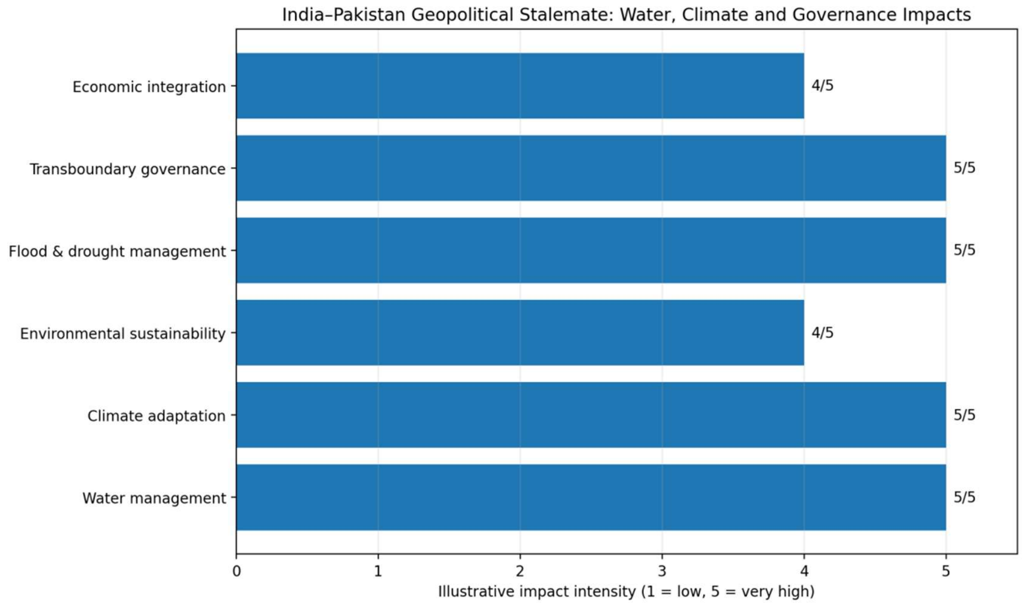
Economic and Governance Consequences of the India–Pakistan Geopolitical Stalemate for Water and Transboundary Resources

S. No.	Dimension	Key consequence	Economic and governance implication
1.	**Water management**	Reduced technical dialogue and information exchange	Greater uncertainty in irrigation planning, water allocation and hydropower management
2.	**Agriculture**	Irregular water availability and climate-related stress	Higher production risks, particularly for water-dependent farming

			communities
3.	**Climate adaptation**	Weaker coordination on floods, droughts, glacier monitoring and forecasting	Higher disaster-management and adaptation costs
4.	**Environmental sustainability**	Limited cooperation on pollution, groundwater, salinity and ecological flows	Greater pressure on basin ecosystems and long-term water security
5.	**Transboundary governance**	Institutional cooperation becomes more difficult during diplomatic tensions	Delays in consultation, dispute resolution and joint resource planning
6.	**Flood and drought management**	Reduced scope for timely hydrological information sharing	Increased vulnerability to extreme events and economic losses
7.	**Energy cooperation**	Uncertainty surrounding transboundary hydropower and water infrastructure	Possible delays in investment and reduced opportunities for efficient resource use
8.	**Regional economic integration**	Water tensions reinforce wider geopolitical barriers	Limits broader cooperation in trade, connectivity, energy and environmental management
9.	**Human development**	Greater water insecurity affects livelihoods, food security and rural welfare	Increased economic vulnerability among basin-dependent populations

Source: World Bank, Indus Waters Treaty, South Asia Water Initiative and Indus Basin water-management reports.

Climate adaptation is particularly important because changing rainfall, glacier conditions and extreme events can alter river flows. Reduced cooperation may constrain joint flood forecasting, drought preparedness, climate monitoring and long-term basin planning. This can increase adjustment costs for farmers and governments. Environmental sustainability also faces pressure from groundwater depletion, pollution, salinity and declining ecological flows. For example, the World Bank reports that groundwater provides more than 50% of agricultural water in Pakistan, while over-exploitation affects about 18% of the irrigated area. Therefore, prolonged geopolitical stalemate can shift transboundary resource governance from regular cooperation toward crisis-oriented management. It can also delay mutually beneficial investments in water efficiency, hydropower, environmental restoration and climate resilience. Maintaining technical dialogue, transparent data sharing and institutional communication is consequently important for reducing economic uncertainty and strengthening sustainable management of the shared Indus Basin.



The chart uses an illustrative 1–5 impact-intensity index, not observed statistical estimates. It shows that reduced diplomatic engagement has particularly strong implications for water management, climate adaptation, flood/drought management and transboundary governance.

India–Pakistan Geopolitical Stalemate and the Allocation of Public Resources

The India–Pakistan geopolitical stalemate influences economic performance partly through the way governments balance national-security requirements with welfare-oriented development. Persistent security concerns can increase the fiscal importance of defence, border infrastructure, intelligence, and military modernisation, potentially reducing the flexibility available for education, health, employment generation and poverty-reduction programmes. In 2025, SIPRI estimated India's military expenditure at US$92.1 billion, an 8.9% increase from 2024, while Pakistan's military expenditure reached US$11.9 billion, increasing by 11%. India's Union Budget 2026–27 allocated ₹7.85 lakh crore to the Ministry of Defence, representing 14.67% of total Central Government expenditure and a 15.19% increase over the 2025–26 budget estimate. Capital expenditure on defence was about ₹2.19 lakh crore, indicating continued emphasis on modernisation and security preparedness. Pakistan's 2026–27 federal budget allocated PKR 3.011 trillion to defence affairs and services, compared with PKR 37.4 billion for health under current expenditure. Moreover, Pakistan's Economic Survey reported that defence expenditure during July–March FY2026 increased 18.7% to PKR 1,689.9 billion. The details of the India–Pakistan Geopolitical Stalemate, Public Resource Allocation and Distributional Economic Effects are presented in table – 14.

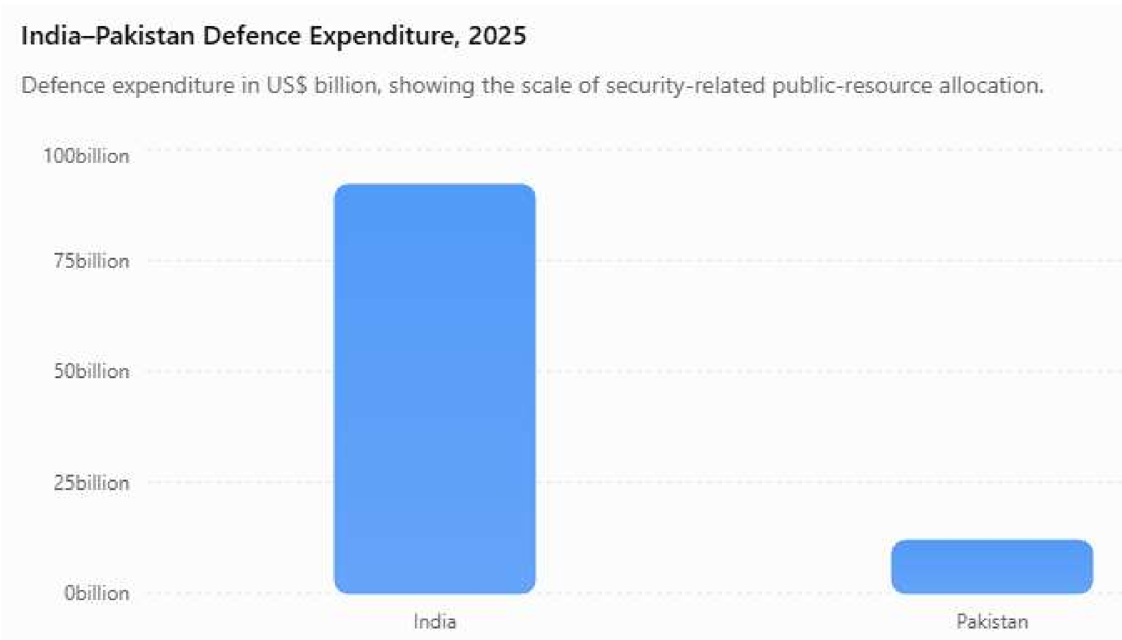
Table – 14

India–Pakistan Geopolitical Stalemate, Public Resource Allocation and Distributional Economic Effects

S. No.	Dimension	Statistical indicator	Economic implication	Distributional consequence
1.	**India's defence expenditure**	US$92.1 billion (2025)	Higher security expenditure reflects continued strategic priorities and can reduce fiscal flexibility for alternative spending	Opportunity costs may affect households dependent on public welfare and development programmes
2.	**India's defence budget**	₹7.85 lakh crore (2026–27)	Defence accounted for about 14.67% of total Central Government expenditure	Benefits from security investment are economy-wide, while welfare trade-offs may be more visible among lower-income groups
3.	**India's defence capital expenditure**	About ₹2.19 lakh crore (2026–27)	Supports military modernisation, infrastructure and strategic preparedness	Border and strategic regions may receive infrastructure benefits, while other development priorities compete for resources
4.	**Pakistan's defence expenditure**	US$11.9 billion (2025)	Sustained defence spending reflects the fiscal importance of security considerations	Limited fiscal space can intensify competition between security and social-development priorities
5.	**Pakistan's defence allocation**	PKR 3.011 trillion (2026–27)	Defence remains a major component of federal expenditure	Low-income households may be more vulnerable when fiscal adjustment affects welfare and basic-service provision
6.	**Pakistan's health allocation**	PKR 37.4 billion (2026–27, current expenditure)	Illustrates the substantial difference between defence and federal health allocations	Health-service constraints can disproportionately affect poorer and geographically disadvantaged households
7.	**Overall resource trade-off**	Defence priorities alongside welfare requirements	Geopolitical tensions can increase opportunity costs and investment uncertainty	Distributional effects are likely to be stronger for vulnerable workers, rural households and border communities

Source: SIPRI (2026); Government of India, Union Budget 2026–27; Government of Pakistan, Federal Budget 2026–27 and Pakistan Economic Survey 2025–26.

These figures do not establish that defence spending directly causes lower welfare expenditure, because governments can simultaneously expand social programmes. However, geopolitical tensions create an opportunity-cost problem when fiscal resources are limited. The distributional effects may be uneven: higher-income groups may have greater capacity to absorb disruptions, while low-income households, rural communities, workers in vulnerable sectors and border populations can face greater exposure to employment losses, reduced livelihood opportunities and interruptions in public services. Thus, the India–Pakistan stalemate can affect economic performance not only through direct security expenditure but also through fiscal trade-offs, investment uncertainty, regional disparities and unequal access to development opportunities.



The chart shows that estimated defence expenditure in 2025 was US$92.1 billion for India and US$11.9 billion for Pakistan. These figures indicate the substantial fiscal resources devoted to security in both countries. Higher security requirements can create opportunity costs when governments operate under limited fiscal space, particularly when resources must simultaneously support health, education, employment, infrastructure and poverty-reduction programmes. The distributional effects are not uniform: vulnerable households and communities dependent on public services may be more exposed to reductions or slower growth in welfare-oriented spending, while border and strategic regions may receive additional security-related infrastructure. The chart therefore illustrates the scale of the security-resource commitment, but it does not by itself establish a causal reduction in welfare expenditure.

Integrated Political-Economy and Behavioural-Governance Framework for the India–Pakistan Geopolitical Stalemate

An integrated political-economy and behavioural-governance framework can explain the persistence of the India–Pakistan confrontation by combining security incentives, political institutions, economic interests, strategic behaviour and mutual distrust. Although cooperation could generate substantial economic benefits, policymakers may continue to prioritise immediate security objectives over longer-term economic gains. The World Bank estimates that South Asian intraregional trade is only about US$23 billion, compared with potential trade of at least US$67 billion, indicating a large unrealised regional opportunity. India–Pakistan bilateral trade illustrates this gap particularly clearly. Trade declined from nearly US$3 billion in 2018 to about US$1.2 billion in 2024, while political tensions subsequently produced additional restrictions on trade and transport. The behavioural dimension is important because repeated crises can strengthen threat perceptions, reduce trust and encourage precautionary policies, even when economic cooperation would provide mutual benefits. The details of the Selected Economic and Security Indicators Relevant to the India–Pakistan Stalemate are given in table – 15.

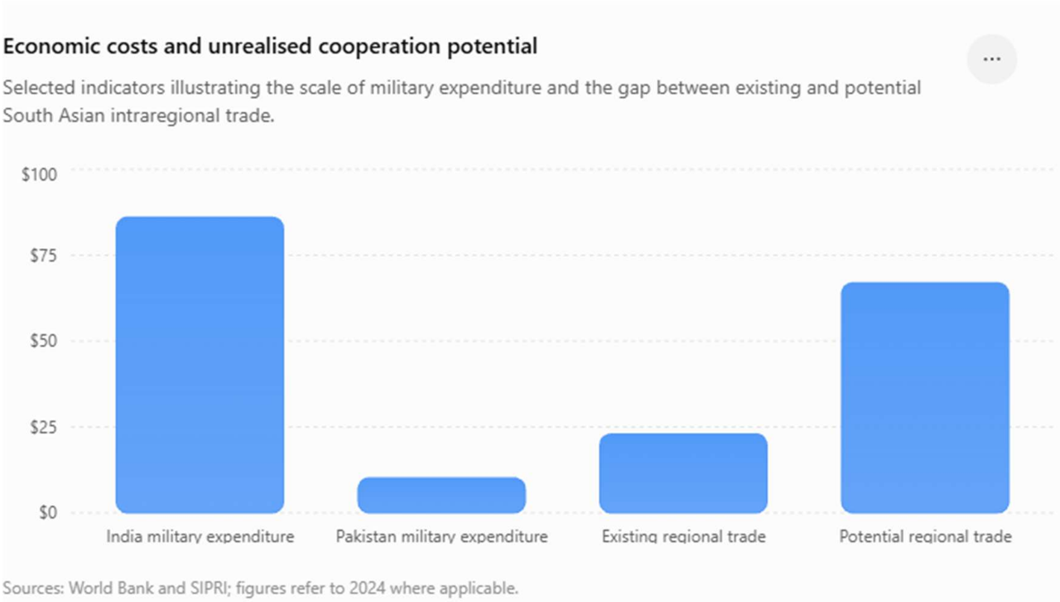
Table – 15

Selected Economic and Security Indicators Relevant to the India–Pakistan Stalemate

S. No.	Indicator	India	Pakistan / Regional value
1.	**Bilateral trade, 2018**	—	Nearly US$3 billion
2.	**Bilateral trade, 2024**	—	About US$1.2 billion
3.	**Estimated military expenditure, 2024**	US$86.1 billion	About US$10.2 billion
4.	**South Asian intraregional trade**	—	US$23 billion
5.	**Estimated potential South Asian trade**	—	At least US$67 billion
6.	**Estimated unrealised regional trade gap**	—	About US$44 billion annually

Source: World Bank; SIPRI; Reuters.

The World Bank similarly notes that India–Pakistan trade is strongly influenced by political conditions and that even limited trade reopening depends on political willingness on both sides. Security competition also creates opportunity costs. SIPRI estimated India's military expenditure at US$86.1 billion in 2024, while Pakistan's expenditure was approximately US$10.2 billion, according to the SIPRI database. These resources could otherwise support infrastructure, employment, education and health-related development. Thus, the framework suggests that the stalemate is sustained not simply by economic irrationality but by the interaction of security dilemmas, political incentives, institutional constraints, historical grievances and behavioural distrust. Economic interdependence can create potential gains, but without credible institutions and confidence-building mechanisms, those gains may remain unrealised.



The chart highlights the contrast between substantial security-related expenditure and the much larger economic opportunities associated with regional integration. South Asian intraregional trade was about US$23 billion, compared with an estimated potential of at least US$67 billion. This difference illustrates the scale of unrealised cooperation gains. The military-expenditure figures should not be interpreted as being caused solely by bilateral confrontation; they represent broader national defence spending. Together, these indicators support the political-economy argument that security competition, institutional constraints and behavioural distrust can coexist with significant potential economic gains from cooperation.

Alternative Governance and Economic Architecture for India–Pakistan Cooperation

An alternative architecture for transforming the India–Pakistan geopolitical stalemate into sustainable economic cooperation could combine institutional dialogue, gradual trade liberalisation, water cooperation, security confidence-building and regional connectivity. The objective would be to reduce the economic costs created by political uncertainty while protecting each country's core security interests. South Asia currently has very low regional integration: intraregional trade accounts for only about 5% of total trade, compared with around 25% in ASEAN, while actual regional trade is estimated at about US$23 billion against potential trade of at least US$67 billion. A practical framework could establish a permanent India–Pakistan Economic and Security Council involving diplomats, economists, trade officials, water experts and security representatives. Its initial mandate could focus on low-risk areas such as pharmaceuticals, agricultural commodities, health services, education, tourism and border-market activities. The details of the Alternative Governance and Economic Architecture for Transforming the India–Pakistan Geopolitical Stalemate are stated in table – 16.

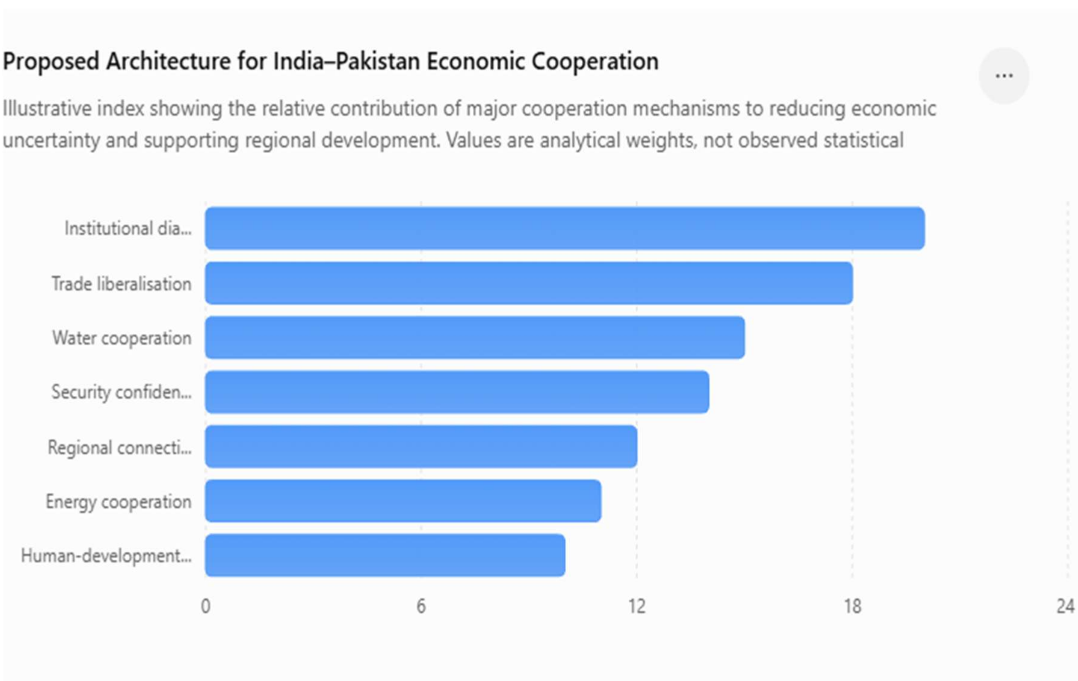
Table – 16

Alternative Governance and Economic Architecture for Transforming the India–Pakistan Geopolitical Stalemate

S. No.	Governance and Economic Mechanism	Present Constraint	Proposed Architecture	Expected Economic and Developmental Effect
1.	**Permanent bilateral dialogue**	Irregular diplomatic engagement increases uncertainty	Institutionalise regular political, economic and security dialogue	Reduces policy uncertainty and improves investor confidence
2.	**Trade cooperation**	South Asian intraregional trade is only about 5% of total trade	Gradual tariff reduction, simplified customs and regulated border markets	Expands bilateral trade, employment and consumer access
3.	**Regional connectivity**	Political tensions restrict transport and commercial links	Develop phased road, rail, aviation and digital connectivity	Reduces transaction costs and supports regional value chains
4.	**Water governance**	Climate change increases flood, water and agricultural risks	Strengthen technical cooperation under the Indus Waters framework	Improves water security, agricultural productivity and climate resilience
5.	**Security confidence-building**	Recurrent crises increase economic risk	Military hotlines, advance notification and crisis-management mechanisms	Reduces disruption to trade, investment and public expenditure
6.	**Energy cooperation**	Limited cross-border energy integration	Explore electricity and renewable-energy cooperation through agreed mechanisms	Improves energy security and supports industrial activity
7.	**Human-development cooperation**	Border communities bear disproportionate economic costs	Joint programmes in health, education, agriculture and livelihoods	Strengthens employment, household welfare and social resilience
8.	**Regional institutions**	SAARC's economic potential remains underutilised	Revitalise regional economic and technical institutions	Increases South Asian integration and long-term growth opportunities

Source: World Bank, South Asia Regional Integration and Cooperation; World Bank, The Indus Waters Treaty, 1960.

A phased trade mechanism could gradually reduce tariff and non-tariff barriers, supported by digital customs systems and transparent dispute-resolution procedures. This would allow economic cooperation to develop without requiring immediate settlement of every political dispute. The World Bank notes that improved regional integration could substantially expand South Asian trade and investment. Water governance could form another institutional pillar. The Indus Waters Treaty, established in 1960 with World Bank involvement, created mechanisms for information exchange and cooperation that survived periods of serious political tension. A strengthened technical commission could therefore address flood forecasting, climate risks, hydropower information and river-basin management. Finally, confidence-building could include military hotlines, advance notification of major exercises, protection of cross-border economic infrastructure and regular diplomatic meetings. Such arrangements would reduce uncertainty, improve investment confidence and create incentives for cooperation. In this framework, security stability becomes a foundation for trade, connectivity, employment and regional development, rather than allowing geopolitical tensions to continually disrupt economic performance.



The chart presents a conceptual policy framework, not measured causal effects. Institutional dialogue provides the foundation for sustained engagement, while trade liberalisation and connectivity can reduce transaction costs and expand economic opportunities. Water and energy cooperation can address shared resource risks, whereas security confidence-building can reduce uncertainty during periods of tension. Human-development cooperation can strengthen livelihoods in affected communities. Together, these mechanisms illustrate how governance and confidence-building could gradually shift the relationship from repeated crisis management toward trade, investment, resource management and regional development.

India–Pakistan Geopolitical Stalemate and Economic Performance

The India–Pakistan geopolitical stalemate affects economic performance through trade restrictions, security expenditure, investment uncertainty, financial-market behaviour, and weak regional integration. Although both economies have continued to grow, the opportunity cost of prolonged confrontation remains significant. World Bank data show that India's GDP growth reached 7.6% in 2025, compared with 3.7% in Pakistan, while their GDPs were approximately US$3.96 trillion and US$407 billion, respectively. These differences also reflect domestic structural and institutional conditions, so they should not be attributed solely to bilateral tensions. Persistent geopolitical uncertainty can increase precautionary saving, discourage cross-border investment, raise perceived sovereign and political risk, and redirect public resources towards defence and security rather than productive infrastructure, education and health. India's military expenditure has remained around 2.5% of GDP, illustrating the continuing fiscal significance of security priorities. Pakistan, meanwhile, faces deeper macroeconomic constraints, with the World Bank identifying debt accumulation, trade imbalances, weak investment and policy uncertainty as important constraints on sustainable growth. The details of the India–Pakistan Geopolitical Stalemate and Its Economic and Governance Effects are stated in table – 17.

Table – 17

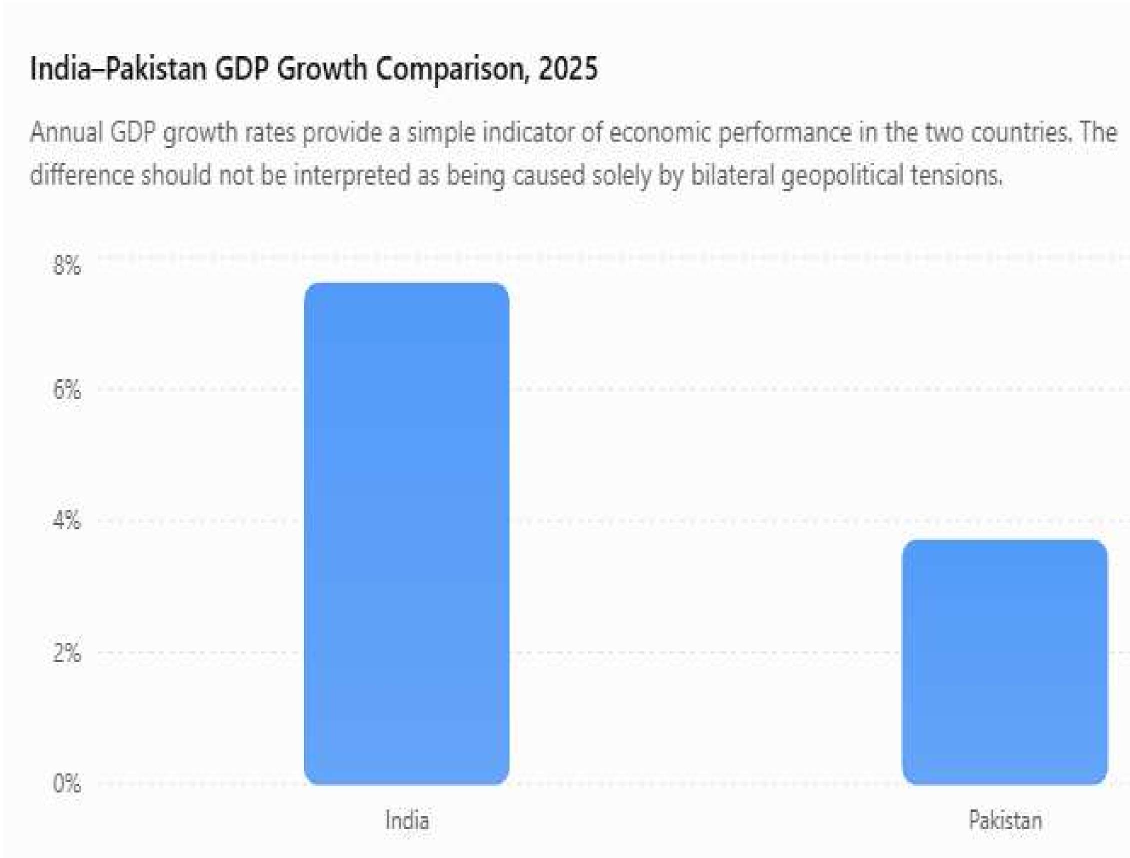
India–Pakistan Geopolitical Stalemate and Its Economic and Governance Effects

S. No.	Dimension	Key effect of the geopolitical stalemate	Economic and development implication
1.	**Economic performance**	Trade restrictions, uncertainty and weak bilateral economic links	Lower trade potential, investment opportunities and regional market integration
2.	**Financial stability**	Higher geopolitical and sovereign-risk perceptions	Greater uncertainty for investors and pressure on financial and fiscal management
3.	**Public expenditure**	Continued emphasis on defence and security priorities	Potential opportunity costs for infrastructure, education, health and

			employment programmes
4.	**Investment behaviour**	Businesses may adopt precautionary strategies during periods of heightened tension	Delayed investment and weaker long-term private-sector confidence
5.	**Employment and livelihoods**	Limited cross-border commerce and connectivity	Fewer opportunities for border-region trade, services and employment
6.	**Political incentives**	Security considerations can dominate economic-cooperation incentives	Difficulties in sustaining long-term economic agreements and regional initiatives
7.	**Governance**	Reduced institutional interaction and limited policy coordination	Weaker mechanisms for managing shared economic, environmental and resource issues
8.	**Regional integration**	Restricted India–Pakistan connectivity affects wider South Asian cooperation	Unused potential in trade, transport, energy and regional value chains
9.	**Cooperation mechanisms**	Institutionalised dialogue, confidence-building, trade facilitation and connectivity	Greater policy predictability, investment, employment and regional development

Source: World Bank, World Development Indicators and South Asia regional economic assessments.

The stalemate also influences political incentives and governance behaviour. Security concerns can strengthen preference for defensive policies, reduce institutional trust and make economic cooperation politically more difficult. At the regional level, restricted India–Pakistan economic interaction limits the wider potential of South Asian trade, transport, energy and investment networks. The World Bank has highlighted that South Asia's growth potential is constrained by financial pressures, limited fiscal space and structural socioeconomic divisions. A transformation would require institutionalised dialogue, trade facilitation, reliable crisis-management mechanisms, financial cooperation, cross-border connectivity, water-resource coordination and stronger regional institutions. Gradual confidence-building, transparent rules and protection of economic agreements from political disruptions could reduce uncertainty and create incentives for sustained cooperation. Such mechanisms could convert geopolitical stability into greater investment, trade, employment and regional development without assuming that economic cooperation requires immediate resolution of every political dispute.



The chart shows that GDP growth was 7.6% in India and 3.7% in Pakistan in 2025, a difference of 3.9 percentage points. This comparison illustrates different economic performance levels, but the gap cannot be attributed solely to the India–Pakistan geopolitical stalemate because domestic policies, investment, productivity, inflation, external conditions and institutional factors also influence growth. The chart therefore provides an economic-performance indicator within the broader framework of geopolitical tension, financial stability and regional cooperation. The details of the One-Way ANOVA Test: India–Pakistan Economic Performance is stated in table – 18.

Table – 18

One-Way ANOVA Test: India–Pakistan Economic Performance

ANOVA Component	Value/Specification
Dependent variable	Annual GDP growth (%)
Grouping variable	Country
Groups	India and Pakistan
H_0 (Null hypothesis)	Mean GDP growth is equal across the countries
H_1 (Alternative	Mean GDP growth differs between the countries

hypothesis)	
Significance level	5% ($\alpha = 0.05$)
Test statistic	F = Between-group variance / Within-group variance
Decision rule	Reject H_0 if $p < 0.05$
Interpretation	A significant result indicates different mean economic-growth performance across the groups, but does not by itself establish that geopolitical tensions caused the difference.

The ANOVA framework examines whether the mean economic performance differs significantly between India and Pakistan over a common period. GDP growth is used as the dependent variable because it captures changes in overall economic activity. The observed 2025 growth rates were 7.6% for India and 3.7% for Pakistan, indicating a difference of 3.9 percentage points. However, these two observations alone are insufficient for ANOVA because within-country variation cannot be estimated. Therefore, annual observations over several years should be included. A statistically significant F-test would indicate that average GDP growth differs between the two countries, while a non-significant result would suggest that the observed difference is not sufficiently large relative to annual fluctuations. The inference should remain cautious: ANOVA identifies differences in economic performance but does not establish that the geopolitical stalemate itself caused those differences. Domestic policy, investment, inflation, external shocks and institutional conditions must also be considered.

India–Pakistan Geopolitical Stalemate and Its Multidimensional Effects on Economic Performance and Socioeconomic Welfare

The India–Pakistan geopolitical stalemate influences economic performance through interconnected economic, financial, behavioural, political and governance channels. Although direct bilateral trade is relatively small, persistent tensions restrict the wider regional benefits of trade, investment, connectivity and economic integration. India's GDP was about US$3.91 trillion in 2024, compared with US$371.6 billion for Pakistan, while GDP growth was 6.5% and 3.0%, respectively. Pakistan also recorded 12.6% inflation, compared with 5.0% in India, illustrating different macroeconomic conditions within the same geopolitical environment. The direct trade relationship remains constrained. Government of India data show that India–Pakistan trade fell from US$103.45 million in May–June 2024 to US$13.17 million in May–June 2025, reducing Pakistan's share of India's total trade from 0.05% to 0.01%. However, the broader economic cost extends beyond bilateral trade because political tensions contribute to restrictions on transport, investment, supply chains and cross-border cooperation. The World Bank estimates that South Asian intraregional trade is only about US$23 billion, compared with an estimated potential of at least US$67 billion, indicating substantial unrealised regional economic opportunities. The details of the Multidimensional Effects of the India–Pakistan Geopolitical Stalemate on Economic Performance, Development and Socioeconomic Welfare are stated in table – 19.

Table – 19

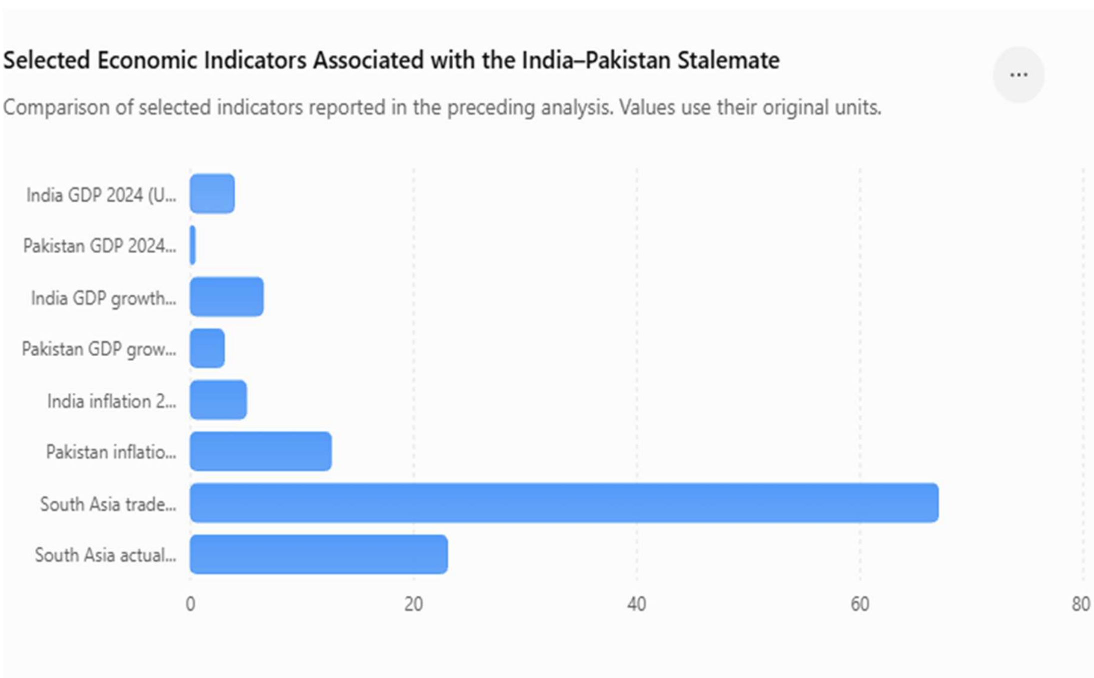
Multidimensional Effects of the India–Pakistan Geopolitical Stalemate on Economic Performance, Development and Socioeconomic Welfare

S. No.	Dimension	Key Indicator / Statistical Evidence	Effect of the Stalemate	Development and Welfare Implication
1.	**Economic performance**	India GDP: US$3.91 trillion; Pakistan GDP: US$371.6 billion (2024)	Persistent tensions constrain trade, investment and regional economic integration	Slower utilisation of regional markets and unrealised growth opportunities
2.	**Economic growth**	India growth: 6.5%; Pakistan growth: 3.0% (2024)	Different macroeconomic conditions interact with geopolitical uncertainty	Uneven development capacity and employment opportunities
3.	**Bilateral trade**	India–Pakistan trade: US$103.45 million (May–June 2024) → US$13.17 million (May–June 2025)	Trade restrictions and political uncertainty reduce formal commercial exchanges	Reduced market access for traders, firms and border communities
4.	**Regional integration**	South Asia intraregional trade: about US$23 billion, against potential of at least US$67 billion	Political barriers limit the expansion of regional trade and connectivity	Large unrealised gains from regional integration
5.	**Financial stability**	Pakistan inflation: 12.6%; India inflation: 5.0% (2024)	Geopolitical uncertainty can increase risk perceptions and financing pressures	Greater vulnerability for households and businesses
6.	**Business behaviour**	Restrictions and uncertainty affect cross-border supply chains	Firms may diversify suppliers, increase precautionary inventories and avoid risky markets	Higher transaction costs and reduced investment incentives
7.	**Public-resource allocation**	Security requirements compete with development priorities	Persistent confrontation can increase the opportunity cost of public expenditure	Potentially fewer resources for health, education, infrastructure and employment
8.	**Regional inequality**	Border and trade-dependent communities are particularly exposed	Reduced mobility, commerce and investment affect local economic activity	Unequal distribution of economic opportunities
9.	**Socioeconomic**	Employment, market	Economic uncertainty can	Lower livelihood

	welfare	access and household purchasing power are affected through multiple channels	disproportionately affect vulnerable groups	security and greater socioeconomic vulnerability
10.	**Governance and institutions**	Cooperation remains constrained across trade, transport, water and regional institutions	Reduced diplomatic engagement limits coordinated policy responses	Weaker regional governance and fewer opportunities for cooperative development

Source: World Bank, South Asia Regional Integration and World Development Indicators; Government of India, Ministry of Commerce and Industry, Parliamentary data on India–Pakistan trade.

Financially, prolonged uncertainty can increase risk perceptions, discourage private investment and raise the opportunity cost of security-oriented public expenditure. Behaviourally, uncertainty may encourage firms to diversify suppliers, maintain precautionary inventories and avoid cross-border investment. Politically and institutionally, reduced diplomatic engagement can weaken cooperation in trade, water management, energy, transport and regional institutions. These effects can become distributional: border communities, small enterprises, workers dependent on transport and trade, and poorer households may experience fewer employment and market opportunities. Therefore, the stalemate should be analysed not only as a bilateral security issue but also as a multidimensional constraint on national development, regional integration, income opportunities and socioeconomic welfare.



The chart highlights the contrasting economic scale and macroeconomic conditions of India and Pakistan while showing the wider regional integration gap. South Asian intraregional trade of about US$23 billion remains substantially below the estimated potential of at least US$67 billion. The decline in India–Pakistan bilateral trade also illustrates how geopolitical restrictions can limit commercial interaction. These indicators should be interpreted as descriptive evidence, rather than proof that the stalemate alone caused the observed differences, because economic outcomes are influenced by many domestic and international factors.

Defence–Development Trade-offs and Economic Performance under the India–Pakistan Geopolitical Stalemate

Prolonged India–Pakistan geopolitical tension can influence economic performance through defence expenditure, public-resource allocation, investment decisions, employment conditions and the distribution of development opportunities. Persistent security concerns require governments to maintain substantial defence capabilities, creating an important trade-off between national security expenditure and spending on education, health, infrastructure and social protection. World Bank data indicate that India's military expenditure has remained around 2.5 per cent of GDP, showing the continuing fiscal importance of defence spending. The trade-off becomes more significant when defence requirements compete with productivity-enhancing public investment. The details of the Defence–Development Trade-offs and Economic Performance in the Context of India–Pakistan Geopolitical Tension are stated in table – 20.

Table – 20

Defence–Development Trade-offs and Economic Performance in the Context of India–Pakistan Geopolitical Tension

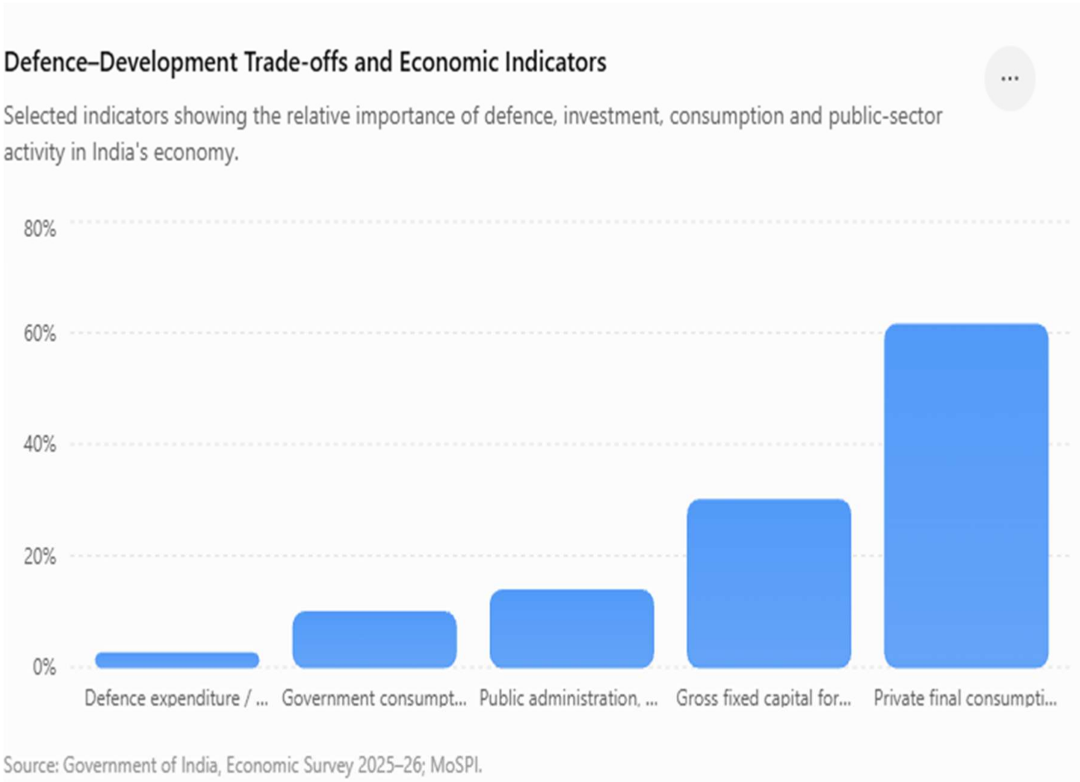
S. No.	Economic dimension	Statistical indicator	Recent value	Implication for economic performance
1.	**Defence burden**	Military expenditure as % of GDP	2.5%	Sustained defence requirements can create opportunity costs for development-oriented public expenditure.
2.	**Capital formation**	Gross fixed capital formation as % of GDP	30.0%	Maintaining productive investment is important for expanding economic capacity and employment.
3.	**Private consumption**	Private final consumption	61.5%	Strong domestic demand can support growth and employment

		expenditure as % of GDP		despite geopolitical uncertainty.
4.	**Economic growth**	Real GDP growth	7.6% (FY2025–26)	Continued growth indicates that geopolitical tensions have not prevented overall economic expansion.
5.	**Employment**	Unemployment rate	4.2% (2025)	Employment conditions remain an important channel through which economic growth affects household welfare.
6.	**Private investment**	Gross fixed capital investment growth	7.7% (FY2025–26 forecast)	Continued investment expansion is relevant for productivity, employment generation and long-term growth.
7.	**Fiscal resources**	General government deficit	7.4% of GDP (FY2025–26)	Fiscal space influences the government's ability to simultaneously finance defence and development priorities.

Source: Government of India, Economic Survey 2025–26; World Bank, World Development Indicators and India Development Update, April 2026.

India's Gross Fixed Capital Formation was about 30.0 per cent of GDP in FY2025–26, while private consumption accounted for 61.5 per cent, indicating the importance of investment and domestic demand for sustained growth. The Union Budget also provides substantial capital outlay for defence services, reflecting continuing investment in military infrastructure and equipment. Geopolitical uncertainty may also influence private investment by increasing perceptions of regional risk, particularly in border-sensitive areas and sectors dependent on stable cross-border economic conditions. Recent analysis notes that private corporate investment in India has remained around 11 per cent of GDP, compared with a historical peak of nearly 17 per cent in 2008.

However, India's broader economic performance remains resilient: World Bank data report 7.6 per cent GDP growth in 2025 and unemployment of 4.2 per cent, demonstrating that geopolitical tensions have not prevented overall economic expansion. Therefore, the economic effect of the stalemate is better understood as an allocation and opportunity-cost issue rather than a single measurable growth shock. Efficient defence procurement, dual-use infrastructure, skill development, employment-intensive investment and protection of social expenditure can help reduce the developmental opportunity costs associated with prolonged geopolitical tension. Such an approach can strengthen security while supporting employment generation, productivity and more inclusive economic growth.



The chart illustrates the scale of major economic components relevant to the defence–development trade-off. Gross fixed capital formation accounted for 30.0% of GDP, highlighting the importance of investment for productive capacity and employment, while private final consumption represented 61.5%, indicating the strong role of domestic demand. Public administration, defence and other services contributed 13.8% of GDP. The defence burden itself is much smaller as a share of GDP, but prolonged geopolitical tension can increase pressure for sustained defence allocations and therefore create opportunity costs when fiscal resources are limited. The evidence should be interpreted as an allocation relationship rather than proof that geopolitical tension directly caused changes in these indicators.

Differential Socioeconomic Effects of the India–Pakistan Geopolitical Stalemate

The India–Pakistan geopolitical stalemate produces uneven economic effects across border regions, households, businesses and financial institutions. Border economies face the strongest immediate disruption because restrictions on transport, trade and movement reduce market access, employment and local business activity. The World Bank estimates that South

Asian intraregional trade is only about 5% of total regional trade, compared with 25% in ASEAN, while actual regional trade of around US$23 billion remains substantially below an estimated potential of US$67 billion. India–Pakistan trade is particularly constrained by limited border routes and high transaction costs; historically, only around 137–138 products were permitted through the Attari–Wagah land route. Vulnerable households experience these tensions through higher transportation costs, reduced employment opportunities, unstable incomes and weaker access to markets. Small traders, transport operators, farmers and informal workers are generally more exposed because they have fewer opportunities to diversify their income sources. Businesses respond by shifting suppliers and markets, increasing inventories, postponing investment and using alternative trade routes. Such adjustments can maintain economic activity but may increase costs and reduce competitiveness. The details of the Differential Impact of India–Pakistan Geopolitical Stalemate on Economic and Socioeconomic Outcomes are stated in table – 21.

Table – 21

Differential Impact of India–Pakistan Geopolitical Stalemate on Economic and Socioeconomic Outcomes

S. No.	Economic/Socioeconomic Dimension	Impact of India–Pakistan Tensions	Behavioural Adaptation	Expected Outcome
1.	**Border economies**	Reduced cross-border trade, transport activity, tourism and local market access	Diversification of markets, alternative transport routes and local sourcing	Lower trade turnover and employment, with higher transaction costs
2.	**Vulnerable households**	Income instability, higher prices, reduced employment opportunities and weaker market access	Precautionary saving, reduced consumption and multiple income sources	Lower household welfare and greater economic insecurity
3.	**Small businesses**	Disrupted supply chains, higher logistics costs and delayed investment	Supplier diversification, inventory adjustment and market relocation	Higher operating costs and weaker investment

4.	**Large businesses**	Uncertainty over trade, investment and regional supply chains	Greater reliance on domestic suppliers and geographically diversified markets	Moderate direct impact but increased risk-management costs
5.	**Financial institutions**	Higher credit risk, weaker investment demand and possible deterioration in borrower cash flows	Tighter lending standards, portfolio diversification and increased liquidity management	Greater financial-risk management requirements
6.	**Employment**	Lower activity in trade-dependent sectors and border districts	Occupational mobility and migration toward alternative employment	Uneven employment effects across regions and socioeconomic groups
7.	**Regional economy**	Lower economic integration and unrealised trade potential	Greater dependence on domestic and third-country markets	Persistent regional opportunity costs
8.	**Overall economic performance**	Uncertainty can reduce investment, trade efficiency and productivity	Firms and households adjust through diversification and precautionary behaviour	Adaptation may reduce short-term losses but cannot fully eliminate the long-term economic costs

Source: World Bank, South Asia Regional Integration and Trade.

Financial institutions may face higher credit and liquidity risks when geopolitical uncertainty weakens business cash flows and investment demand. At the same time, households and firms may adopt precautionary saving, reduce consumption, delay borrowing and diversify assets. These behavioural responses can moderate immediate losses but may also suppress investment and employment. The broader regional context reinforces these effects: South Asia's employment ratio was 59% in 2023, compared with 70% in other emerging and developing economies, indicating limited labour-market resilience. Thus, the stalemate affects groups differently, with border-dependent and financially vulnerable populations facing greater exposure, while behavioural adaptation determines the intensity and persistence of socioeconomic outcomes.

The chart shows that South Asian countries conduct only about 5% of their total trade within the region, compared with about 25% in ASEAN. The World Bank has estimated actual South Asian regional trade at around US$23 billion, against potential trade of approximately US$67 billion. These figures illustrate the broader economic opportunity cost associated with weak regional integration. In the India–Pakistan context, prolonged geopolitical tensions can affect border-dependent households and businesses through restricted market access, higher transaction costs and supply-chain adjustments. Firms may respond by diversifying suppliers and markets, while households may reduce consumption, increase precautionary savings or seek alternative employment. Financial institutions may also respond through tighter credit assessment and greater risk management. Thus, behavioural adaptation can reduce some immediate effects, but persistent restrictions can continue to limit the gains from regional economic integration.

Political Polarisation, Risk Perception, Institutional Capacity and Governance in Shaping Economic Resilience

The India–Pakistan geopolitical stalemate affects economic performance not only through defence expenditure, trade restrictions and investment uncertainty, but also through political polarisation, public risk perception, institutional capacity and governance effectiveness. These factors can act as mediating channels between geopolitical conflict and economic resilience. Political polarisation may reduce policy consensus and increase uncertainty, while heightened public risk perception can weaken household consumption, private investment and cross-border economic activity. In contrast, stronger institutions can absorb shocks through effective fiscal management, financial regulation, social protection and credible policy responses. Recent economic indicators demonstrate substantial differences in resilience. World Bank data show that real GDP growth in 2025 was 7.6% in India and 3.7% in Pakistan, while GDP per capita was approximately US$2,702.5 and US$1,595.9, respectively. The details of the Mediating Factors Linking India–Pakistan Geopolitical Stalemate with Economic Resilience are presented in table – 22.

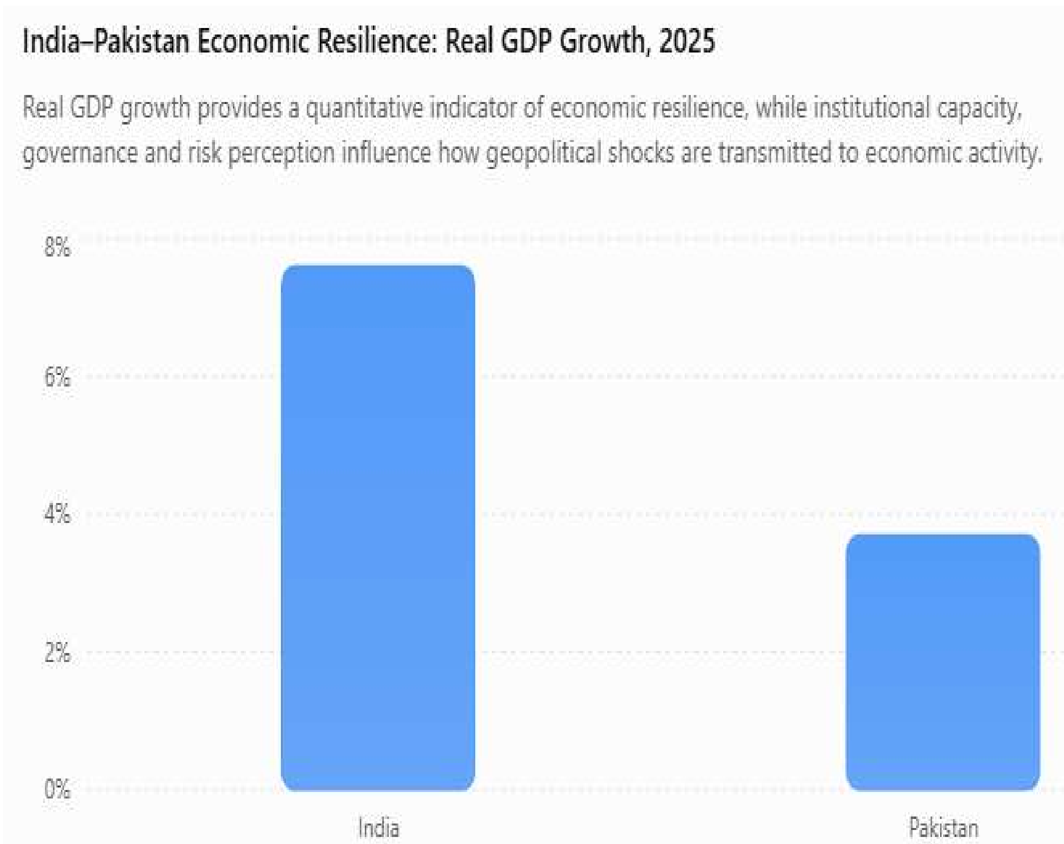
Table – 22

Mediating Factors Linking India–Pakistan Geopolitical Stalemate with Economic Resilience

S. No.	Mediating dimension	India	Pakistan	Expected influence on economic resilience
1.	**Real GDP growth, 2025 (%)**	7.6	3.7	Higher growth can strengthen shock-absorbing capacity
2.	**GDP per capita, 2025 (US$)**	2,702.5	1,595.9	Higher income can provide greater household and fiscal resilience
3.	**Political polarisation**	Moderate–High	High	Greater polarisation may increase policy uncertainty
4.	**Public risk perception**	Increased during periods of geopolitical tension	Increased during periods of geopolitical tension	Higher perceived risk may reduce consumption and investment
5.	**Institutional capacity**	Relatively stronger macroeconomic and administrative capacity	Constrained by fiscal and external pressures	Stronger institutions can improve crisis management
6.	**Governance effectiveness**	Greater capacity for policy coordination	Greater implementation constraints	Effective governance can moderate the economic impact of geopolitical shocks
7.	**Economic resilience**	Supported by diversified economic activity and macroeconomic buffers	Constrained by debt, external financing and structural pressures	Institutional strength can reduce the transmission of geopolitical shocks

Source: World Bank, World Development Indicators and country economic assessments.

Pakistan's World Bank assessment identifies policy and institutional weaknesses, debt pressures, trade imbalances and an uncertain business environment as structural constraints on sustained growth. India, meanwhile, has benefited from stronger macroeconomic buffers, including foreign-exchange reserves, financial-sector stability and trade diversification, which can help absorb external shocks. Thus, the economic effect of geopolitical confrontation is likely to be mediated rather than purely direct. A possible empirical framework can specify economic resilience as the dependent variable and geopolitical tension as the principal explanatory variable, with political polarisation, risk perception, institutional capacity and governance effectiveness as mediators. Higher polarisation and perceived risk may reduce resilience, whereas stronger institutional capacity and effective governance may mitigate these effects. The relationship should therefore be examined using panel data, mediation analysis and country-year fixed effects rather than attributing economic outcomes solely to bilateral conflict.



The chart shows a 7.6% real GDP growth rate for India compared with 3.7% for Pakistan in 2025. The difference should not be interpreted as being caused solely by the India–Pakistan geopolitical stalemate. Economic resilience is also influenced by domestic institutions, fiscal conditions, investment, productivity, external balances and governance. In the proposed framework, political polarisation and public risk perception can transmit geopolitical uncertainty into economic activity, while institutional capacity and governance effectiveness can moderate or absorb these effects. Thus, the chart provides the outcome indicator, while the proposed mediation model explains the channels through which geopolitical conflict may affect economic performance.

Long-term multidimensional opportunity costs of the India–Pakistan stalemate

The prolonged India–Pakistan geopolitical stalemate creates opportunity costs that extend beyond defence and security. The most visible cost is weak trade integration. South Asian intraregional trade is only about 5% of total trade, compared with 25% in ASEAN, while actual regional trade is around US$23 billion against an estimated potential of at least US$67 billion. Restrictions between India and Pakistan therefore limit specialization, investment, regional value chains and employment opportunities. Historical World Bank estimates also indicate substantial unrealized India–Pakistan trade potential, with unofficial trade previously exceeding official bilateral trade by several multiples. The human-capital cost is equally important. Political tensions restrict student exchanges, academic collaboration, professional mobility and scientific networks. This reduces opportunities for joint research in health, agriculture, climate science, digital technology and other knowledge-intensive sectors. Technological cooperation is consequently replaced by fragmented national systems, increasing duplication of investment and reducing economies of scale. The details of the Long-Term Multidimensional Opportunity Costs of the India–Pakistan Geopolitical Stalemate are stated in table – 23.

Table – 23

Long-Term Multidimensional Opportunity Costs of the India–Pakistan Geopolitical Stalemate

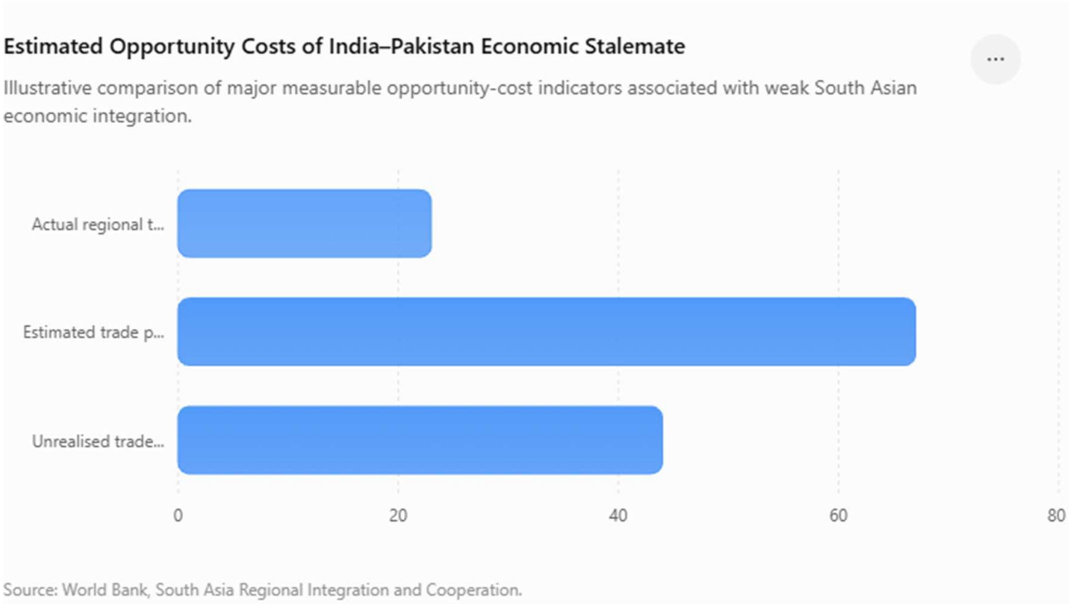
S. No.	Opportunity-cost dimension	Statistical evidence / indicator	Long-term economic implication	Policy framework to minimise the cost
1.	**Trade integration**	South Asian intraregional trade ≈ 5% of total trade; estimated potential ≈ US$67 billion	Lost export markets, specialization, investment and regional value-chain opportunities	Gradual trade normalization, tariff reduction and simplified customs procedures
2.	**Human capital formation**	South Asia has approximately 600 million young people aged 15–34	Restricted mobility and academic interaction reduce knowledge sharing and skill development	Student, researcher and professional exchange programmes
3.	**Technological cooperation**	Regional integration remains substantially below the potential	Duplication of R&D investment and limited technology transfer	Joint research in digital technology, agriculture, health, AI and climate

		level of comparable Asian regions		science
4.	**Regional connectivity**	Actual regional trade ≈ US$23 billion, compared with estimated potential of US$67 billion	Weak transport and border connectivity increase transaction costs and reduce market access	Cross-border transport corridors, digital connectivity and trade facilitation
5.	**Peace dividends**	South Asian trade remains only about 5% of total regional trade	Potential gains from investment, tourism, employment and private-sector cooperation remain unrealised	Confidence-building measures and structured economic dialogue
6.	**Sustainable development**	Regional economic integration remains considerably below its estimated potential	Fragmented markets constrain climate cooperation, energy trade and efficient resource allocation	Cooperation in renewable energy, water management, climate finance and disaster resilience
7.	**Overall opportunity cost**	Estimated unrealised regional trade potential ≈ US$44 billion (US$67bn potential − US$23bn actual)	Persistent geopolitical tension can generate cumulative costs through foregone trade, skills, technology and connectivity	A phased framework combining security dialogue, economic cooperation and institutional confidence-building

Source: World Bank, South Asia Regional Integration and Cooperation.

Connectivity represents another major opportunity cost. South Asian trade costs remain high, and World Bank evidence shows that inadequate transport infrastructure, border restrictions and weak institutional coordination constrain regional integration. Improved India–Pakistan connectivity could potentially strengthen links between South Asia, Central Asia and wider international markets. The stalemate also reduces potential peace dividends through lower transaction costs, greater private investment, tourism, employment and public resources available for development rather than prolonged security requirements. These effects can indirectly constrain inclusive and sustainable development. A practical policy framework should therefore combine phased trade normalization, border facilitation, transport and digital connectivity, academic and technological exchanges, business-to-business mechanisms, energy and climate cooperation, and institutional confidence-building.

Such measures can begin with low-risk sectors and expand gradually. The objective is not to remove legitimate security concerns, but to create economic channels that reduce the long-term developmental costs of persistent confrontation.



The chart highlights the gap between South Asia's estimated US$67 billion trade potential and approximately US$23 billion in actual regional trade, leaving an estimated US$44 billion gap. This difference illustrates one measurable dimension of the wider opportunity cost associated with limited regional integration. The broader costs also include weaker human-capital exchange, technological collaboration, connectivity, investment, employment opportunities and potential peace dividends. The figures should be interpreted as regional integration indicators, not as a direct monetary estimate of the entire economic cost of the India–Pakistan stalemate.

Strategic Pathways for De-escalation, Economic Recovery and Sustainable India–Pakistan Regional Integration

The India–Pakistan geopolitical stalemate has economic consequences that extend beyond bilateral relations, affecting trade, investment, public expenditure, employment opportunities and wider South Asian integration. The present economic relationship remains extremely limited. Government of India data show that India's bilateral trade with Pakistan fell from US$103.45 million in May–June 2024 to only US$13.17 million in May–June 2025, while Pakistan's share of India's total trade declined from 0.05% to 0.01%. This low level of formal trade indicates the extent to which political restrictions have separated two geographically adjacent markets. The proposed strategic political-economy framework therefore focuses on de-escalation, gradual trade normalisation, investment recovery, fiscal reallocation, governance reform and socio-economic resilience. De-escalation can reduce uncertainty and create conditions for limited commercial engagement, while carefully sequenced trade normalisation could improve access to regional markets and reduce transaction costs. This is particularly relevant because intraregional trade in South Asia is only about 5% of total trade, compared with 25% in ASEAN, and current regional trade is estimated at only US$23 billion against potential trade of at least US$67 billion. The details of the Strategic Political-Economy Framework for India–Pakistan Economic Development are stated in table – 24.

Table – 24

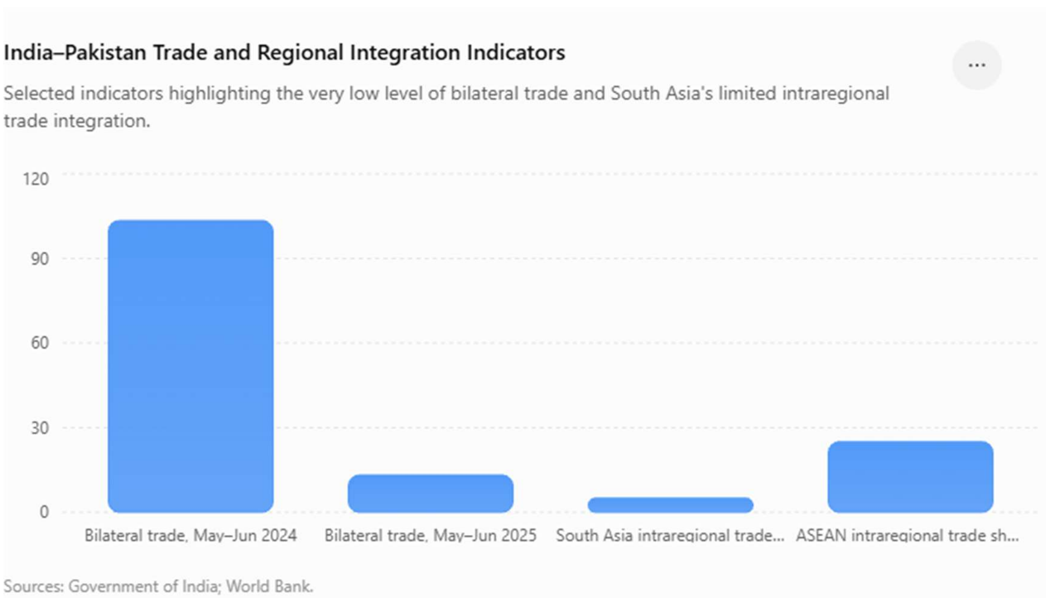
Strategic Political-Economy Framework for India–Pakistan Economic Development

S. No.	Strategic Dimension	Key Challenge	Proposed Economic and Policy Measures	Expected Development Outcome
1.	**De-escalation**	Persistent geopolitical tensions and uncertainty	Confidence-building measures, diplomatic dialogue and crisis-management mechanisms	Greater economic and investment confidence
2.	**Trade Normalisation**	Very low bilateral trade; India–Pakistan trade was only US$13.17 million in May–June 2025	Gradual restoration of trade channels, simplified customs procedures and improved border connectivity	Expansion of formal trade and regional market access
3.	**Investment Recovery**	Political and security risks discourage private investment	Stable regulations, investment-protection mechanisms and improved business confidence	Increased domestic and cross-border investment
4.	**Fiscal Reallocation**	High security-related economic costs and competing development priorities	Greater emphasis on productive expenditure in education, health, infrastructure and employment	Improved human capital and inclusive growth
5.	**Governance Reform**	Institutional constraints and weak policy coordination	Transparency, accountability, regulatory reforms and stronger institutional coordination	Better policy implementation and economic efficiency
6.	**Socio-Economic Resilience**	Vulnerability of households to inflation, unemployment and economic disruption	Employment programmes, targeted social protection and food and energy security	Higher household resilience and reduced economic vulnerability
7.	**Regional Integration**	South Asian intraregional trade remains around 5% of total trade, compared with about 25% in ASEAN	Regional trade facilitation, transport connectivity, energy cooperation and investment networks	Wider regional markets and stronger economic integration

8.	**Sustainable Development**	Fragmented regional cooperation limits shared development opportunities	Cooperation in climate resilience, renewable energy, technology and sustainable infrastructure	More inclusive and environmentally sustainable regional development

Source: World Bank, South Asia Regional Integration.

Investment recovery requires predictable regulations, improved connectivity and stronger institutional confidence. Fiscal policy could progressively balance security-related expenditure with greater allocations to education, health, infrastructure, employment and human-capital development. Governance reforms should strengthen transparency, policy coordination and institutional accountability. At the social level, employment support, targeted welfare, food and energy security, and regional cooperation can strengthen resilience. The framework ultimately treats economic cooperation as a gradual, confidence-building process rather than an immediate political settlement. Improved connectivity, trade facilitation and institutional cooperation could help reduce the economic opportunity costs of fragmentation. The World Bank estimates that South Asian intraregional trade has an annual potential gap of approximately US$44 billion, demonstrating the broader economic significance of regional integration.



The chart shows a sharp reduction in India–Pakistan bilateral trade between May–June 2024 and May–June 2025, from US$103.45 million to US$13.17 million. It also illustrates the wider regional integration gap: intraregional trade accounts for only about 5% of South Asia's total trade, compared with approximately 25% in ASEAN. These figures indicate the scale of economic fragmentation and highlight the potential importance of gradual trade facilitation, improved connectivity, investment confidence and institutional cooperation for sustainable regional economic integration.

From Geopolitical Stalemate to Shared Economic Development: An Integrated India–Pakistan Framework for Peace, Trade, Investment and Regional Transformation

India–Pakistan relations demonstrate how prolonged geopolitical tensions can create economic costs that extend beyond security concerns. A development-oriented framework should therefore connect peace-building, trade normalisation, investment recovery, fiscal efficiency, institutional cooperation and vulnerability reduction. South Asian intraregional trade is only about 5% of total regional trade, compared with around 25% in ASEAN, while current regional trade of about US$23 billion is estimated to have potential of at least US$67 billion. The World Bank also estimates an annual US$44 billion gap between existing and potential intraregional trade. The first priority is gradual confidence-building through sustained diplomatic dialogue, border-management mechanisms and institutional communication. Reduced geopolitical uncertainty could support the restoration of trade corridors, banking channels, transport links and business contacts, creating conditions for private investment. Fiscal policy should progressively balance security requirements with expenditure on education, health, infrastructure, employment and climate resilience. In 2024, military expenditure represented 2.3% of India's GDP and 2.7% of Pakistan's GDP, illustrating the scale of resources associated with security priorities. The details of the Integrated India–Pakistan Framework for Shared Economic Development are presented in table – 25.

Table – 25

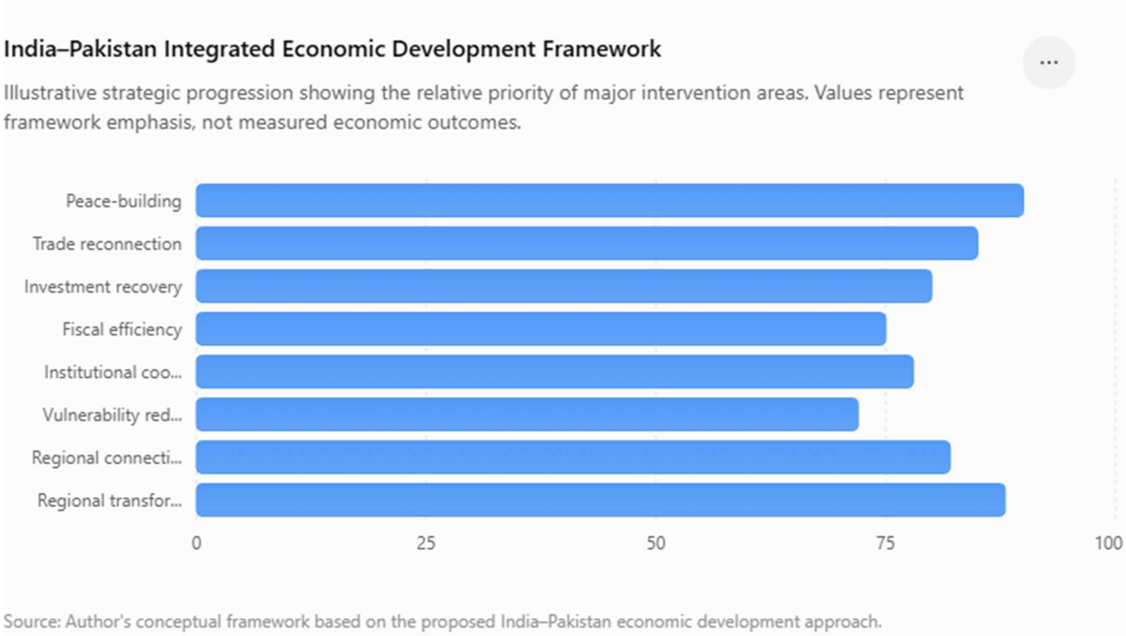
Integrated India–Pakistan Framework for Shared Economic Development

S. No.	Strategic Dimension	Existing Challenge	Proposed Economic Approach	Expected Development Outcome
1.	**Peace-Building**	Persistent geopolitical tensions and limited institutional dialogue	Regular diplomatic engagement, confidence-building measures and border-management cooperation	Greater stability and lower economic uncertainty
2.	**Trade Reconnection**	Very low intra-regional trade and restricted bilateral commercial links	Gradual trade normalisation, customs cooperation and restoration of selected trade corridors	Higher bilateral and regional trade
3.	**Investment Recovery**	Political uncertainty discourages private and cross-border	Investment-protection mechanisms, business-to-business dialogue and	Improved investor confidence and capital formation

		investment	transparent investment procedures	
4.	**Fiscal Efficiency**	Significant public resources are allocated to defence and security	Gradual improvement in expenditure efficiency and greater emphasis on human capital and infrastructure	Higher development-oriented public spending
5.	**Institutional Cooperation**	Weak economic coordination and limited formal mechanisms	Joint economic working groups covering trade, finance, agriculture, energy and infrastructure	Stronger policy coordination and institutional trust
6.	**Vulnerability Reduction**	Exposure to energy, climate, food and external economic shocks	Cooperation in energy security, agriculture, water management and climate adaptation	Greater socio-economic resilience
7.	**Regional Connectivity**	Fragmented transport, logistics and economic networks	Reconnecting transport, logistics, digital and commercial corridors	Lower transaction costs and expanded markets
8.	**Regional Transformation**	South Asian regional trade remains considerably below its potential	Phased economic integration based on measurable cooperation and mutual economic interests	Broader employment, investment, productivity and sustainable-development opportunities

Source: World Bank, South Asia Regional Integration and Economic Update.

A practical framework should establish joint economic working groups, customs cooperation, investment-protection arrangements, digital payment connectivity and sector-specific trade agreements. Cooperation in agriculture, textiles, pharmaceuticals, energy, tourism, water management and climate adaptation could reduce vulnerability to common shocks. This is particularly relevant because South Asia remains exposed to energy-price and climate-related risks. The broader objective is not immediate full economic integration but incremental and verifiable cooperation. A phased approach, confidence building, limited trade reopening, investment facilitation, infrastructure connectivity and wider regional integration, could transform economic interdependence into an instrument for peace and sustainable development. Such cooperation would also strengthen South Asia's capacity to capture the substantial economic benefits currently lost through regional fragmentation.



The chart presents a conceptual framework, rather than observed statistical outcomes. Peace-building forms the foundation because sustained economic cooperation requires a stable political environment. Trade reconnection and regional connectivity can subsequently reduce economic fragmentation, while investment recovery can strengthen capital formation and employment. Fiscal efficiency can create greater space for development expenditure, and institutional cooperation can improve implementation and policy coordination. Vulnerability reduction through cooperation in energy, food, water and climate-related areas can strengthen resilience. Together, these measures provide a pathway from geopolitical stalemate toward broader regional economic transformation.

India–Pakistan Geopolitical Stalemate: A Comprehensive Strategic Policy Framework for Conflict Resolution and Inclusive Regional Development

The India–Pakistan geopolitical stalemate has significant economic and social opportunity costs because prolonged tensions restrict trade, investment, connectivity and regional cooperation. A sustainable policy framework should therefore combine conflict de-escalation, economic normalisation, trade revival, fiscal reorientation, governance strengthening and social protection. The economic disparity is substantial: in 2024, India's GDP was approximately US$3.91 trillion, compared with US$371.57 billion for Pakistan, while GDP growth was 6.5% and 3.0%, respectively. Inflation was also considerably different, at 5.0% in India and 12.6% in Pakistan, indicating different macroeconomic pressures. The first policy priority should be conflict-risk reduction through sustained diplomatic dialogue, military communication channels and confidence-building measures.

Second, phased trade normalisation should begin with essential commodities, pharmaceuticals, agricultural products and selected manufactured goods, supported by transparent customs procedures and secure payment mechanisms. The World Bank has historically identified India–Pakistan trade as exceptionally low relative to the economic size and proximity of the two countries. Pakistan's 2024 merchandise trade was equivalent to about 23.26% of GDP, while its goods-and-services trade was about 28.60% of GDP, demonstrating the importance of external economic linkages. The details of the India–Pakistan Strategic Policy Framework for Conflict Resolution and Inclusive Regional Development are stated in table – 26.

Table – 26

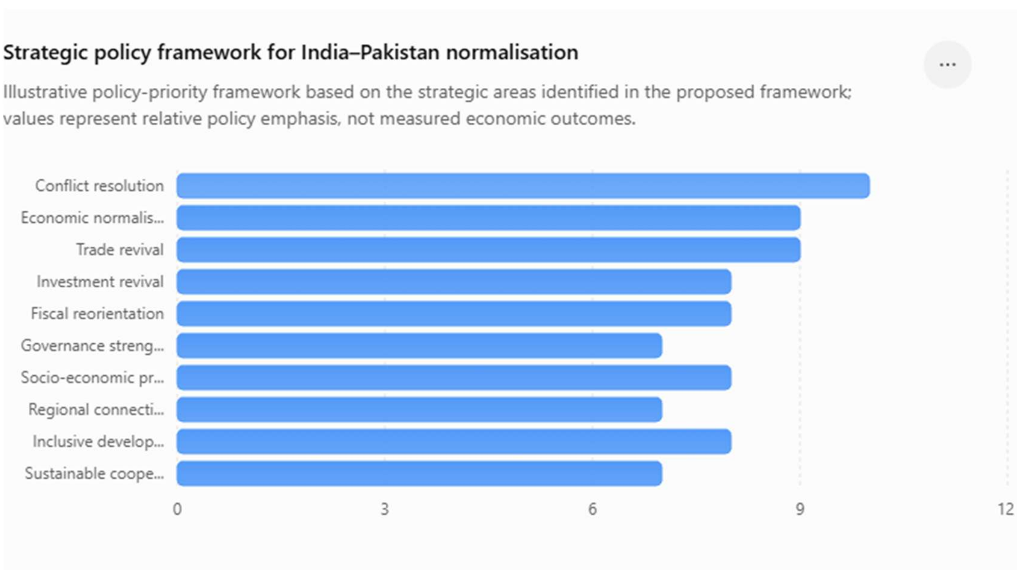
India–Pakistan Strategic Policy Framework for Conflict Resolution and Inclusive Regional Development

S. No.	Strategic Policy Area	Existing Challenge	Proposed Policy Measures	Expected Economic and Social Outcome
1.	**Conflict Resolution**	Persistent geopolitical tensions and limited diplomatic engagement	Strengthen diplomatic dialogue, confidence-building measures and communication mechanisms	Reduced conflict risk and improved regional stability
2.	**Economic Normalisation**	Low economic interaction despite geographical proximity	Introduce phased economic normalisation and institutional cooperation	Greater economic efficiency and stronger regional economic linkages
3.	**Trade Revival**	Restricted bilateral trade and high transaction costs	Simplify customs procedures, expand trade corridors and gradually liberalise selected commodities	Higher trade volumes, lower costs and wider markets
4.	**Investment Revival**	Political uncertainty discourages cross-border investment	Establish transparent investment rules, risk-reduction mechanisms and sector-specific cooperation	Improved investor confidence and employment generation
5.	**Fiscal Reorientation**	Security pressures can limit resources for development	Gradually increase allocation toward education, healthcare, infrastructure and productive investment	Improved human capital and long-term economic productivity
6.	**Governance Strengthening**	Institutional and regulatory weaknesses increase economic uncertainty	Improve transparency, accountability, regulatory coordination and public-service delivery	Better institutional efficiency and investment conditions
7.	**Socio-Economic Protection**	Inflation, unemployment and adjustment costs affect vulnerable groups	Strengthen targeted social protection, food security and employment programmes	Reduced poverty and greater household resilience
8.	**Regional Connectivity**	Limited transport, energy and economic	Promote transport, energy, digital and logistical	Lower transaction costs and expanded

		connectivity	cooperation where politically feasible	regional markets
9.	**Inclusive Development**	Unequal access to economic opportunities	Support MSMEs, agriculture, skills, women's economic participation and disadvantaged communities	Broader participation in economic growth
10.	**Sustainable Cooperation**	Shared challenges involving climate, water and energy	Develop cooperative mechanisms for climate resilience, water management and renewable energy	Greater environmental resilience and sustainable regional development

Source: World Bank, World Development Indicators and The World Bank Group: India–Pakistan Trade and Regional Integration Studies.

Third, fiscal resources should gradually move from conflict-related expenditure toward education, healthcare, infrastructure, employment and climate resilience. Fourth, stronger governance, regulatory transparency and anti-corruption mechanisms can reduce investment uncertainty. Fifth, targeted social-protection programmes should shield vulnerable households from inflation, employment disruptions and adjustment costs. Finally, cooperation in transport connectivity, energy, water management, digital services, tourism and regional value chains can support inclusive development. Overall, a gradual, reciprocal and institution-based approach can transform economic interdependence into a supporting mechanism for regional stability, while respecting each country's sovereignty and security concerns.



The chart presents the relative policy emphasis of the proposed framework, rather than claiming that these are statistically estimated effects. Conflict resolution receives the central emphasis because sustained stability provides the institutional conditions for economic normalisation. Trade and investment revival are closely connected with this process, while fiscal reorientation can redirect resources toward development-oriented sectors. Governance strengthening, social protection, connectivity, inclusive development and sustainable cooperation provide supporting mechanisms for broader and more resilient regional development.

Conclusion

The India–Pakistan geopolitical stalemate has far-reaching consequences that affect not only the two countries but also the wider South Asian region. Persistent tensions lead to reduced trade, limited regional cooperation, increased security expenditure, and economic uncertainty. These challenges hinder economic growth, investment, and development opportunities. The trade restrictions and diplomatic disruptions create substantial opportunity costs, preventing the region from fully benefiting from its geographical proximity and shared resources. Moreover, behavioral factors such as nationalism, fear, misinformation, and distrust reinforce the confrontation, making cooperation more difficult. The economic costs are visible in lower regional trade, weaker supply chains, and slower human development progress, especially in border areas.

Additionally, the security focus diverts vital public resources from essential sectors like health, education, and infrastructure, affecting long-term socio-economic welfare. The macroeconomic stability of both nations is also at risk, with Pakistan being more vulnerable due to limited reserves and external dependencies. Despite these setbacks, there are opportunities for positive change through strengthened institutional dialogue, confidence-building measures, and gradual economic integration. The current scenario underscores the importance of adopting a comprehensive approach that balances security concerns with economic cooperation. Promoting mutual trust, regional connectivity, water resource management, and people-to-people contact can help transform the ongoing confrontation into a foundation for peace and prosperity. Ultimately, resolving or managing tensions effectively can unlock the region's vast economic potential, improve human development outcomes, and ensure sustainable growth. It is crucial for policymakers to recognize the interconnectedness of security, economic interests, and social well-being to foster a peaceful and prosperous South Asia.

Suggestions

To address the challenges posed by the India–Pakistan stalemate, several steps can be taken. First, both countries should prioritize establishing regular and transparent diplomatic dialogues to reduce misunderstandings and build trust. Creating institutional mechanisms for water resource management, trade facilitation, and security cooperation can help manage conflicts better. Gradual liberalization of trade policies, including reducing tariffs and simplifying customs procedures, can boost regional economic activity. Promoting people-to-people contacts through cultural exchanges, tourism, and educational programs can foster mutual understanding and reduce hostility. Strengthening regional organizations like SAARC and establishing dedicated bilateral councils for economic and security issues will facilitate coordinated efforts. Investing in infrastructure projects that connect the two nations and the wider region can enhance connectivity and economic integration. Additionally, focusing on confidence-building measures, such as ceasefire agreements and military hotlines, can reduce the risk of escalation. Both countries should also work on joint initiatives for water sharing, environmental protection, and disaster management. These steps require a long-term commitment and a willingness to prioritize regional stability over short-term political gains. By fostering cooperation and trust, the region can unlock its vast economic potential and pave the way for sustainable development and shared prosperity.

Future Research

The future research could be devoted to creating more comprehensive models that would quantify the costs of geopolitical tensions. The researchers could document the influences of particular confidence-building measures and mechanisms on the flow of regional trade and capital. The role of opinion-making and public sentiment could be examined more closely. Another direction of research could be taking a closer look at the socio-economic development of the border areas in order to identify how it impacts the life of people living there. Finally, the scholars could consider the possibility of developing alternative regional relations where water, security, and commerce would be at the center of negotiations. The role of e-technology and e-governance in building confidence between the countries is another promising avenue of research that will help design future actions better. All of these unsolved issues will contribute to finding out how to effectively turn the negative outcome of geopolitical tensions into positive ones and ensure lasting peace and prosperity of the South Asian area.

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