

INDIA'S INTERNATIONAL ISOLATION AND ITS IMPLICATIONS FOR PAKISTAN'S INDUSTRIAL AND ECONOMIC OPPORTUNITIES IN SOUTH ASIA

Muhammad Ammar Masood Cheema

Centre for Entrepreneurial Mindset, GIFT University

ammarcheema15@gmail.com

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Corresponding Author: *
Muhammad Ammar Masood
Cheema

Abstract

The changing international posture of India has been marked by strategic friction, protectionist trade policies, regulatory bottlenecks and reputational problems which has led to a kind of selective international isolation with significant consequences to South Asia. This paper looks at the impact of relative disengagement of India on regional economic forms and provides Pakistan with industrial and economic opportunities. The analysis based on the theories of regional political economy, trade diversion, and strategic decoupling explains changes in the trade patterns, foreign direct investment, supply chains and geopolitical alignments. The results show that the limited external interaction of India creates opportunities to Pakistan in export-oriented production, services, transportation, and linking to the outside world, especially via the China-Pakistan Economic Corridor. Nonetheless, the success of these opportunities will be determined by whether Pakistan manages to overcome domestic structural weaknesses, governance issues and perception risks that are related to security. The research gives a contribution to the South Asian development literature through the repositioning of regional asymmetries and providing policy-based implications to the capitalization of geopolitical change to achieve sustainable economic development.

1. Introduction

1.1 Background and Context

The Indian status on the global stage has been rather recalibrated during the last ten years due to the influence of the changing geopolitical orientations, economic nationalism, and the transformation of strategic priorities. Since being perceived as a defining power of emerging capabilities, which could bring together western and non-western blocs, the foreign policy of India has become more associated with the use of strategic freedom and selective involvement as opposed to the multilateral integration (Mohan, 2004). Although India is still a partner to the key

players in the world, its relations with key players have become complicated and, in some areas, tense.

The ties with the United States and the European Union have increased in security and technological collaboration; although differences in terms of trade protectionism, regulatory obstacles, and even in the aspects of democracy have created recurrent tensions (Pant and Sadhukhan, 2009). At the same time, traditional India-Russia relations have been challenged by the changing dynamics of the global power, and the regime of the sanctions, and the conflict between India and China, pressed against the border by the

economic rivalry, has greatly limited the regional cooperation in the Asian region (Garver, 2001). Such trends have led to India pulling out of regional trade agreements such as the Regional Comprehensive Economic Partnership (RCEP), which strengthens the image of economic inwardness (Baldwin, 2020).

These trends are developing against the background of increased global and regional trade tensions, which have particularly stronger impacts on South Asia, which has already had a poor economic integration rate and political distrust (Shahid and Ahmad, 2021). This is a challenging and latent opportunity to Pakistan, in a constrained regional environment. The Pakistan economy is still under structural constraints such as the lack of diversification in exports, under capacity of the industries, and exposure to external shocks (World Bank, 2023). Nevertheless, changes in regional economic patterns and supply chain schemes can also provide Pakistan with strategic cracks which might help it rebrand its position in South Asia in its changing political economy.

1.2 Conceptualizing “International Isolation”

The concept of international isolation is used in political economy not only in reference to the actual sanctions or diplomatic isolation but a larger state in which a state is deprived of access to global markets, institutions and cooperative structures because it is limited due to political, economic or reputational reasons (Keohane and

Nye, 2012). Notably, isolation is a spectrum phenomenon and not two-state phenomenon. Absolute isolation- where there is almost complete disconnection with the international system is not common in modern international politics. Selective disengagement is more frequent, when states are still engaged in one area and are excluded or opposed in another (Farrell and Newman, 2019).

In the example of India, international isolation takes place in its soft forms. They are the rising trade barriers, unwillingness to sign multilateral trade free agreements, and the growing strategic mistrust towards neighbors, both close and far countries as well as the leading powers (Pant and Sadhukhan, 2009). Reputational cost due to fear of regulatory unpredictability, policy changes, and governance trends are also examples of such soft isolation (Kaushal, 2022). Soft isolation, in contrast to formal sanctions, functions in markets, risk assessment and behavior of the institutions to influence the capital flows and supply chain decisions.

It is important to know the isolated in this subtle way to be able to gauge its regional spillover impacts. Instead of portending a period of diminution, selective isolation has the potential to reinvent regional economic formations, through re-shaping the direction of trade, investment and industrial action to other locations within the same geopolitical locale.

Table 1

Conceptualizing India’s Selective International Isolation

S/N.	Dimension	Indicators	Economic Implications
1.	Trade Policy	Tariffs, RCEP withdrawal	Reduced trade integration
2.	Investment Climate	Regulatory uncertainty	FDI hesitation
3.	Diplomacy	Strategic ambiguity	Reputational costs

1.3 Research Objectives and Significance

This paper seeks to discuss the ways in which the relative and selective international isolation of India is rewriting the economies and industries of South Asia. In particular, it attempts to examine the role of change in the external activity of India on the trade patterns in the region, investment

flows and supply chain configurations, with special reference to the implication to Pakistan.

The second aim is to find new industrial and economic prospects of Pakistan initiated by these changes. The study analyses the capabilities of Pakistan to tactically use the transformation of the regional political economy to become more

competitive in industrial manufacturing, export, and regional connectivity.

The analysis contributes to the research on South Asian political economy and development by going beyond regional power approaches of India as a central country, but rather focuses on how changes in a structure of a core regional economy can create unequal opportunities to other countries in the region. By so doing, it gives a subtle guide to the interpretation of regional economic transformation given the circumstances of selective international isolation.

2. Theoretical Framework and Literature Review

2.1 Regional Political Economy and Economic Power

Asymmetry

The study of the regional political economy focuses on the fact that economic relations at the regional level are seldom symmetrical. Rather, they are influenced by core periphery processes with one dominant economy having disproportionate impact on the pattern of trade, patterns of investment, and institutional agenda (Wallerstein, 2004). In south Asia, India has been a long-time regional core, with a share of this region GDP of more than 70 percent and dominance in quality industrial capacity, market share as well as diplomatic coverage (Bajpai & Pant, 2013). According to the dominant economy theory, this asymmetry will allow the powerful state to influence the regional rules and norms, and at the same time, limit the policy freedom of other smaller neighboring economies (Lake, 2009). Instead of enhancing regional integration, which is conducive to cooperation, domination may create dependency, marginalization as well as resistance especially when there is a lack of political trust. The economical superiority of India in South Asia has not been reflected in the institutional leadership of Germany in the European Union or Japan in East Asia because of the existing political tensions and the hail of perceived hegemonic actions (Dash, 2008). The structural dominance of India has had both positive and negative effects to its neighbors. On the one hand, the market access to the large market of India has provided a potential export

market. Contrarily, trade asymmetries, limited market access, and often unstable politics have curtailed the achievement of these benefits (Sridharan, 2017). In the case of Pakistan, the lack of political conflict resolution has been translated to low levels of trade integration to support the economic fragmentation around the region. As a result, as the dominant economy suffers external limitations or partial non-involvement, the theory of regional political economy anticipates that the peripheral states will have opportunities to reposition themselves by harvesting channeled trade and investment flows, so long as the conditions of the country permit such realignment.

2.2 Trade Diversion and Investment Relocation Theory

The trade diversion theory is a concept that gives an explanation of how political or institutional obstacles may cause the trade flow to be diverted by an efficient producer to other suppliers within or without the region (Viner, 1950). Although originally used to examine customs unions, the idea has been extensively used in situations where market access is skewed by geopolitical conflicts, sanctions, or uncertainty in policy (Baldwin and Wyplosz, 2019). When faced with political pressures, companies attempt to reduce their exposure to risk by moving sourcing and manufacturing operations out of politically sensitive areas, despite the fact that they might be cost-effective.

Not far off is the theory of investment relocation which emphasizes how foreign direct investment (FDI) is sensitive to geopolitical risk, regulatory unpredictability and reputational issues (Alfaro et al., 2011). Empirical research indicates that multinational companies are gradually following the concept of political stability, and policy congruence over the benefits of marginal costs especially in value chains that are global in nature. With increase in the geopolitical risk, FDI is likely to shift to countries that are considered safer or foreseeable within the same region (Busse & Hefeker, 2005).

ASEAN and Eastern Europe evidence can help to justify this logic. In Southeast Asia, China and

Western economies have experienced trade conflicts that have stimulated the shift to production in Vietnam, Indonesia and Malaysia, which is an example of how geopolitical spillovers can be useful to secondary economies (Antràs, 2015). Equally, the EU expansion, as well as the tension with Russia, in Eastern Europe shifted the investment focus to Poland and Czech Republic, instead of the regional heavy weights (Campos and Kinoshita, 2010).

Extended to South Asians, these theories conclude that the selective withdrawal of India on trade agreements and increasing geopolitical tensions can create trade diversion and FDI reallocation impacts. Should Pakistan be in a position to capture some of these diverted flows, it could be possible through alleviating local bottlenecks.

2.3 Economic Nationalism and Strategic Decoupling.

The revival of economic nationalism has become one of the characteristics of the modern global political economy. Economic nationalism gives preference to the domestic industries, strategic independence, and resistance to foreign jolters, typically by use of tariffs, subsidies, and restrictive trade policies (Rodrik, 2018). Although these kinds of policies can contribute to the improvement of domestic control in the short-term, they often lower the international competitiveness and escalate long-term economic isolation.

Resolutely connected to this phenomenon is strategic decoupling, and according to which states intentionally decrease economic interdependence in the vital areas of economy, including technology, manufacturing, and infrastructure (Farrell and Newman, 2020). Along with the increasing anxieties regarding supply chain vulnerability, national security, and technology reliance, strategic decoupling indicates concerns. With the trend towards the fragmentation of global value chains, companies are also looking at alternative production centres that would strike a balance between cost-effectiveness and political trustworthiness (Gereffi, 2020).

The current economic trend of India portrays numerous factors of economic nationalism. The policies of self-reliant India (Atmanirbhar Bharat), the rise in tariffs, the demand of localization, and the departure of significant trade agreements are indicators of the conscious change in the developmental orientation (Rodrik, 2018). Although these actions are designed to support the local manufacturing industry, critics claim that it would jeopardize the integration of India into global value chains, as well as, lowering the competitiveness of its exports (Subramanian and Felman, 2019).

Regionally, nationalistic turn of India is a contributing factor of strategic decoupling as far as South Asia is concerned. Less openness and decreasing regional trade cooperation undermine institutional integration and encourage firms to look away elsewhere. To the other neighboring countries such as Pakistan, this environment can lead to space to draw in this industry that aims at diversifying the region, provided there is a match between the national policy frameworks and the global production needs.

2.4 Gaps in Existing Literature

Although the academic literature on South Asian political economy has grown, relevant gaps in the literature on the ability of the changes in international positioning of India to create an asymmetric economic effect on the rest of the neighboring states persist. The prevailing mass of literature views India as an irreplaceable regional driver of growth, putting emphasis on it as a market, provider of a security system, or leader of institutions (Bajpai and Pant, 2013; Mohan, 2004). This India-centric orientation has narrowed down the scope of analytical focus to the fact that the external engagement limitation of India could result in economic opportunity on the peripheral economies like Pakistan.

In addition, the literature seldom views Pakistan as a possible recipient of reconfiguration of the region economy. Rather, deficit-based discourses and narrations based on political instability, insecurity, and failure in governance have framed Pakistan (Rizvi, 2019). As much as these

challenges are empirically based, these views fail to recognize the structural processes through which Pakistan might attract the economic activity that is moving out of India in circumstances of geopolitical tension, e.g. trade diversion, investment outflow and restructuring of supply chains (Baldwin, 2020). Consequently, industrial aspect of the regional power transformations has been underrepresented in the literature especially in the manufacturing industry, export-focused industries, and the special economic zones.

The other critical gap is that there is no South Asia-centered comparative framework. The partial disengagement of dominant economies has been widely analyzed in comparative political economy research on how such a disengagement alters the production system within the region in East Asia and Eastern Europe (Antràs, 2015; Campos and Kinoshita, 2010). But similar analysis system is not often done to South Asia where chaos of historical conflicts and insufficient institutionalization make it difficult to make comparisons of regions (Dash, 2008). This prevents comparative analysis and policy relevance due to the lack of comparison.

To fill these gaps, the current paper will assume a regional political economy approach that focuses on Pakistan in the dynamic economic context of South Asia. It combines trade, investment and industrial policy analysis and thereby proceeds a more balanced and dynamic analysis of the regional economic change in circumstances of selective international isolation.

3. India's Emerging International Isolation: Causes and Dimensions

3.1 Diplomatic and Strategic Frictions

The changing diplomatic stance of India has been more influenced by the strategic frictions that limit its internationalization and dominance in the region. Principle among them are the repeated border disputes with China especially after the Galwan Valley conflicts of 2020, a major blowback to bilateral relations. These stresses have been economically manifested such as increased investment scrutiny, limits on Chinese technology companies, disruptions of cross-border trade and supply chain (Garver, 2001). Although they are

aimed at protecting the national security, they have also raised the cost of production and have also contributed to the increased levels of uncertainty among investors in the manufacturing and technology industry in India.

On the regional level, India has a poor relationship with South Asian Association of Regional Cooperation (SAARC), which does not maximize the effectiveness of the organization as a tool of economic integration. Continuous politics-related wrangles, most notably with Pakistan have seen summit-level meetings being suspended and SAARC being sidelined in favour of other India-focused projects like BIMSTEC (Dash, 2008). This change has undermined the multilateral collaboration in South Asia and also reinforced the idea that India was an undependable regional leader that did not want to disappoint economic cooperation and political struggle.

In the rest of the world, India, is deliberately ambiguous in its global geopolitics. On the one hand, as India has strengthened its strategic relationships with the United States and the Indo-Pacific partners, it has been opposed to formal relationships and has been maintaining economic and military connections with Russia, especially through the Ukraine conflict (Mohan, 2004). This balancing approach, which is based on the idea of strategic autonomy, has granted India the flexibility but has created tension with the western partners regarding the issue of sanctions compliance, trade standards, and the issue of democratic governance (Pant and Sadhukhan, 2009). Taken together, these diplomatic and strategic frictions serve to add India to the selective international isolation of making it harder to form long-term partnerships, making geopolitical risk premiums more difficult, and making predictability more difficult to sustain economic integration.

3.2 Trade Policy Constraints and Protectionism

The trend in India since the last ten years in terms of its trade policy has been more of a protectionist nature limiting its entry into the global and regional markets. One of the turning points of this trend was the pullout of India in the Regional

Comprehensive Economic Partnership (RCEP) talks in 2019. Though India stands at a strategic point to enter the largest trade bloc in the world, the country raised fears of the influx of imports, protection of the domestic industry, and trade imbalance, especially with China (Rodrik, 2018). This ruling solidified the image of India being unwilling to adhere to multilateral trade liberalization and restricted its entry to the regional value chains.

Simultaneously, India has increased the application of tariff as well as non-tariff barriers as industrial policy tools. There is an increase in average applied tariffs since the mid-2010s especially in manufacturing industries including electronics, automobiles, and chemicals (World Trade Organization [WTO], 2021). The non-tariff policies, such as the localization demands, licensing restrictions, and complexity of regulations have also raised trade costs to foreign companies (Kaushal, 2022). Although they are presented as measures to advance domestic manufacturing within such initiatives as Atmanirbhar Bharat, they have made people concerned about the loss of efficiency and decreased export competitiveness.

The trade posture of India has also been portrayed through growing number of conflicts at the world trade organization. Export subsidies, agricultural assistance, and import quotas have been met with criticism by key trading allies and have led to reputational losses in the world trading system (Bown and Irwin, 2019). All these trade policy restrictions are indicative of partial withdrawal of globalization, which strengthens the previous practice of selective international isolation against India and the push to firms to seek alternative production and export destinations in South Asia.

3.3 Technology, Supply Chain, and Investment Risks

The management of technology and supply chain have emerged as the core of the new risk profile of India in global production networks. The more significant colonial approach to technology transfer has been caused by growing national security and data sovereignty concerns, especially

in digital services, telecommunications, and advanced manufacturing (Aaronson and Leblond, 2018). The various measures that have increased levels of scrutiny of foreign technology firms, data localization and investment screening mechanisms have increased the costs of compliance to multinational enterprises in India.

Such changes in regulation have been accompanied by the growing uncertainty about policy stability and consistency in its enforcement. According to scholars, the problematic aspects of unpredictable regulatory changes that are usually introduced without a lot of consultations increase the risk of operations and detract long-term capital investments (Kaushal, 2022). Such uncertainty can also be highly detrimental to the appeal of the country as a production location in technology-intensive industries with innovation cycles that require cross-border cooperation and intellectual property protection (Gereffi, 2020). Consequently, the desire to become further involved into the global value chains experienced structural limits in India, which are associated with governance and regulatory coherence.

As a result, multinational companies started evaluating the position of India in their supply chains on an international basis. Although India is still a huge consumer base, companies are increasingly considering it as complicated and politically risky production centre than other destinations in the south east (Antras, 2015). The corporate shift patterns in relocation of the manufacturing sector indicate that the manufacturing sector is expanding the geopolitical and regulatory risks instead of focusing all the manufacturing activities in a dominant economy. This re-evaluation should not mean complete decoupling of India but is a sign of a strategic hedging phenomenon that dilutes the centrality of India within the economic supply chains in the region and creates room to rival economies. In the case of South Asia, the dynamics indicate the possibility of redistribution of industrial activity when risk sensitivity is very high.

3.4 Reputational and Soft Power Decline

In addition to the material factors, the reputational and soft power factors have continued to play an increasingly important role in the international economic activity of India. The issues of human rights, the democratic retrogression, and the limitation of civil freedoms became a popular topic in the worldwide discourse about India in the recent years (Freedom House, 2023; Varshney, 2021). The media and other policy-making bodies have spread these stories across the world, and, as a result, they have influenced the way the quality of governance and the reliability of the institutions in India have been perceived.

The focus of the soft power theory is on credibility, norms, and values that determine the attractiveness of a country to attract investments and partners (Nye, 2004). In this regard, reputational devaluation can be converted into actual economic expenses as perceived political risk. Experimental evidence reveals that foreign investors do not only respond to macroeconomic fundamentals but also to governance pointers, rule of law and international reputation (Busse and Hefeker, 2005). Investors might require risk premiums to be increased or shift investor funds to jurisdictions that are seen to be stable as fears of democratic decline and policy arbitrariness increase.

This reputational recalibration has also been achieved by the international institutions and advocacy organizations. The calls of international watchdogs and words of multilateral forums have raised the issue of regulatory transparency, minority rights, and press freedom in India, further undermining the doubt of external stakeholders (Kaushal, 2022). As long as India still exudes cultural and diplomatic power, the loss of normative credibility undermines its soft power bargain in economic diplomacy.

All these reputational processes strengthen the selective international isolation of India, by influencing the behaviour of investors, media stories, and the behaviour of institutions. To the adjacent economies, reputation changes may lead to changes in investment hierarchies at the

regional level as well as impact long-term trends of economic realignment.

4. Shifting Regional Economic Dynamics in South Asia

4.1 Declining Regional Economic Integration

The degree of economic integration between South Asian countries is still among the lowest in the world, and intra-regional trade is already less than 6 percent of total trade, compared to about 24 percent in the case of ASEAN (World Bank, 2022). Regional trade stagnation, in spite of being geographically close and complementary factor endowed, has been experienced because of political conflict, restrictive nature of trade regimes and poor connectivity infrastructure. India being a central location within the region has failed to play an effective leadership role towards the trade liberalization, which has further admired fragmentation.

One of the institutional causes that lead to this stagnation is the stalemate of the South Asian Association of Regional Cooperation (SAARC). SAARC had been relatively dormant on the summit level since 2014, mainly because of the unresolved India-Pakistan tensions (Dash, 2008). Failure to decouple any political wrangles with economic cooperation has compromised the credibility of SAARC and limited its development in regard to regional trade promotion, investment collaboration and integration. Consequently, South Asia is unable to maintain meaningful economic interdependence due to the organizational shallowness that exists there.

In any case, ASEAN is the opposite. Although ASEAN is diversified politically and has a rather complex history of conflicts, it has managed to institutionalize economic collaboration with such frameworks as the ASEAN Free Trade Area and regional production networks (Ravenhill, 2016). The divergence brings out the fact that institutional commitment and political will and not economic fundamentals alone determine the outcome of integrations. This ambivalence in regard to regional multilateralism by India has thus led to the fall in integration, deteriorated South Asia independent economic standing and

stimulated other regional and extra-regional arrangements.

Table 2

Comparative Regional Trade Integration

Region	Intra-Regional Trade (% of total trade)
South Asia	~ 6%
ASEAN	~ 24%
European Union	~ 60%

4.2 Reconfiguration of South Asian Supply Chains

Facing geopolitical risk and trade uncertainty, as well as disruption caused by the pandemic, global supply chains are experiencing a severe reconfiguration as firms react to them. There is a new movement towards diversifying the supply chain and companies are trying to avoid over-dependence on the one-country production centres (Gereffi, 2020). These forces in South Asia interact with India disengagement selectively with regional trade systems and increasing regulatory complexity, influencing firms to review regional production strategies.

The need to move the manufacturing place is being fuelled by the mixture of cost factors and risk reduction. The countries that have competitive labor prices, enhance logistics, and better predictability of the policies are in a better position to attract footloose manufacturing investments (Antràs, 2015). This has seen Southeast Asia gain greatly, but South Asia too is an untapped potential because of the large labour force and the proximity to the major markets (World Bank, 2023). Inward-looking trade position of India could thus make supply chain experiments in the rest of the region quicker.

Supply chain results are determined by the decisive role of logistics infrastructure, the situation on the labor market, and political stability. The transport connectivity and customs have traditionally made South Asia less integrated in the global value chains due to weak connectivity and inefficiencies in customs (Asian Development Bank, 2018). However, these limitations can be partially compensated by specific investments in infrastructure and clusters of industries. The

relative attractiveness of Pakistan is improved by its better logistic routes, good pay system, and strategic location between South Asia and Central Asia and Middle East.

Therefore, when supply chains are reconfigured, it does not mean that they are automatically relocated but it is a progressive redistribution of production. Nations that can integrate the industrial policy to conform to the global needs in production can capture some of the portions of the value chains that are held by the major regional economies in their hands.

4.3 Strategic Realignments by Global and Regional Actors

The economic geography of South Asia is changing due to strategic repositioning by the global and regional actors. China has become a central actor due to increased investment in infrastructure, involvement in trade, and industrial collaboration in the region (Rolland, 2020). As India continues to guard the moves of China within the region, other states of South Asia have adopted the Chinese-led connectivity initiatives to a great extent changing the old hierarchies in the region.

A further intensification of the economic interaction between the Gulf states and South Asia has been due to their diversification policy and food security interest. Pakistan, Bangladesh, and Sri Lanka have also increased investments in energy, logistics, ports, and agriculture and are a wider change in South-South economic cooperation (Ulrichsen, 2018). Equally, states of Central Asia want to have access to warm-water ports and South Asia markets, which underlies the

strategic significance of the regional connectivity corridors.

In this respect, China-Pakistan Economic Corridor (CPEC) is an essential tool of realignment of the region. Being one of the flagships of the Belt and Road Initiative of China, CPEC is expected to increase infrastructure connectivity, industrial collaboration, and energy security in Pakistan (Small, 2020). Although it is still challenged by problems in implementation, CPEC has made Pakistan one of the potential transit and production hubs that can bridge South Asia, Central Asia, and the Middle East.

The geographical positioning and its enhanced connectivity infrastructure gives Pakistan an edge in the era of supply chain diversification. With coherent industrial policy and governance reforms added to them, Pakistan can use these realignments to become more integrated into both regional and extra-regional production networks. Such role would be a major change in political economy of South Asia especially because a relative withdrawal by India has left some room where other economic avenues could be exploited.

5. Industrial Opportunities for Pakistan

5.1 Manufacturing and Export-Oriented Industries

The manufacturing and export-driven sector forms an important avenue that Pakistan can exploit because of changes in regional economic forces. The textile and apparel industry that makes up a significant portion of Pakistani exports presents an opportunity to diversify other than the low-value sectors (Asian Development Bank, 2018). With the global consumers seeking alternative sourcing in Pakistan and China, the country can shift to higher value-added products (technical textiles, synthetic blends, and branded clothes) as long as adherence to global labor and environmental standards is enhanced (World Bank, 2023).

Other potentials are light engineering and consumer goods, which have increased potential beyond textiles. The new Pakistani automotive parts, electrical equipment and household appliances are a fit to the regional trends in demand and supply chain diversification (Ahmed

and Hamid, 2024). The industries have a relatively lower capital intensity and have access to the extensive domestic market in Pakistan as a pilot market on export competitiveness. In addition, the closeness to the markets of South Asia and the Middle East increases the attractiveness of Pakistan as the manufacturing hub in the region. Another promising opportunity is the pharmaceutical industry and medical equipment industry. Pakistan possesses a relatively large local pharmaceutical market that has well-developed regulatory methods and manufacturing capacity (Zaidi et al., 2019). With increasing demand of healthcare in the world market and companies in search of geographical diversification of production, Pakistan can increase the export of generic drugs, surgical equipment, and simple medical equipment. The main opportunities can be achieved through strategic investments in quality certification, research and development and regulatory harmonization. Wholesomely, these manufacturing industries present scaled avenues of industrial upgrading concerning the evolving regional conditions.

5.2 Special Economic Zones and Industrial Policy Leverage

One of the key components of the Pakistani approach to investment inflow and industrialization is Special Economic Zones (SEZs), as part of the China-Pakistan Economic Corridor (CPEC). SEZs are meant to offer firms specific incentives, which are tax breaks, simplified regulatory measures, and special infrastructure, which minimizes the cost of operation and investment risk (Farole & Akinci, 2011). CPEC The various SEZs under CPEC will be designed to support industrial relocation and export manufacture.

Economies of scale, the knowledge spillovers, as well as common logistical networks, facilitate productivity in industrial clustering in SEZs (Porter, 1998). With the focus on firms in the industries, Pakistan will be able to enhance the efficiency of the supply chain and enhance backward and forward connectivity among the local industries. Experience in East Asia indicates

that well-planned SEZs could act as a driver to the overall industrial upgrading in case they are incorporated into the national development strategies (Zeng, 2015).

The potential of SEZs, however, will be achieved only with consistent industrial policy and regulatory reform. The incentives provided by the policy should be clear, limited, and tied to the export outcomes to prevent the rent-seeking behavior (World Bank, 2020). Enhancement of governance, energy security, and skills development are also very important. Provided their proper practice, SEZs can help Pakistan take advantage of the regional changes in production and attract companies that want a different location in South Asia.

5.3 Spillovers in the technology and services sector.

In addition to manufacturing, Pakistan has other valuable spillover opportunities in its technology and services sectors in a reconfiguring regional economy. Information technology (IT) and software business has been a booming export business, with the growing demand of digital services and affordable talent around the world (Saima et al., 2025). With growing digital infrastructure and favorable labor fees, Pakistan is an increasingly appealing place to outsource

services as companies attempt to expand the range of places where they can engage in the service delivery process.

Other development opportunities include business process outsourcing (BPO) and knowledge process outsourcing (KPO). The existence of English-speaking workforce with escalating human capital base, contributes to the growth of Pakistan in customer support, financial services, and data analytics (UNCTAD, 2022). As competition with the established outsourcing centers will keep high, niche specialization and an improvement in quality can make Pakistan more competitive in the global service value chain.

One of the major structural opportunities that lie behind these opportunities is the population balance of Pakistan. A young and developing workforce can be targeted by investment in digital skills and tertiary education and create long-term increases in productivity (World Bank, 2023). The critical area in human capital development is to seize spillovers of manufacturing services linkages such as logistics management, software integration, and industrial automation. Through the match to technology policy and industrial development, Pakistan can use the expansion of the service sector to supplement the growth in manufacturing and strengthen the economy in general.

Table 3

Sectoral Opportunities for Pakistan

Sector	Opportunity Source	Policy Enablers
Textiles	Trade diversion	SEZ incentives
Pharmaceuticals	Supply chain shift	Regulatory reform
IT & BPO	Cost arbitrage	Skill development

6. Economic and Strategic Gains for Pakistan

6.1 Trade Expansion and Market Diversification

The discriminatory refusal of India to engage in regional trade systems and increased protectionism has resulted in improved chances of Pakistan to increase its trade presence past conventional markets. By exporting to non-traditional markets in Southeast Asia, Middle East, and Africa, Pakistan will decrease its traditional reliance on a small range of customers

like the United States and China (World Bank, 2023). Diversification can not only counter regional shock exposure, but it also enables Pakistan to win over parts of the trade once dominated by India especially in the textile, light manufacturing and pharmaceutical sectors (Baldwin, 2020). Market entry can also be enhanced through trade promotion strategies such as attendance of regional trade fairs, bilateral agreements and because of online trade sites. The

competitive advantage in the global markets is also facilitated by taking advantage of the preferential trade schemes like the Generalized System of Preferences (GSP) whereby Pakistan can better fit in the global value chains.

6.2 Foreign Direct Investment and Capital Inflows

The change in the regional economic dynamics can bring foreign direct investment (FDI) to Pakistan, especially to those companies that are seeking alternatives to India because of the increasing regulatory and geopolitical risks (Antràs, 2015). Relocation to strategic industries, especially manufacturing, information technology, and renewable energy is particularly appealing to Pakistan because of the labor cost advantage, the fact that the infrastructure is improving, and that it is well placed to reach regional markets (World Bank, 2023). Pakistan is even more attractive to foreign investors due to investment facilitation systems such as simplified procedures of approvals, one-window operations and incentives under CPEC-based SEZs (Farole and Akinci, 2011). The initial signs are that there are specific policy measures that can lock footloose investment and enhance industrial upgrading and transform geopolitical change into economic benefits.

6.3 Long-Term Strategic Autonomy

Pakistan can minimize the regional economic vulnerability and enhance long-term strategic autonomy through diversification of trade, drawing in redirected FDI, and capitalizing on regional connectivity efforts. The country can strike more conditional terms in regional trade arrangements, bilateral agreements, and it will be in a better bargaining position to the major powers of the region due to the increased industrial and service capabilities (Rolland, 2020). Essentially, selective Indian disengagement has the potential to open structural possibilities of Pakistan to exercise economic resilience and power in the South Asian region in accordance to short and long-term strategic objectives.

7. Challenges and Constraints for Pakistan

7.1 Domestic Structural and Governance Constraints

Although India is relatively isolated, which provides it with some external opportunities, Pakistan itself has considerable structural and governance issues at the domestic level that could restrict its capacity to utilize these opportunities to the maximum. There is a serious energy crunch that has placed a bottleneck on the growth of industries. The common load-shedding, a weak grid infrastructure and the reliance on imported fuels raise the cost of production and competitiveness in export-based industries (Bhatti and Rehman, 2021). Such energy limitations especially impact the manufacturing industries of textile, light engineering, and pharmaceuticals that require continuity and reliability.

Challenges are further because of institutional inefficiencies. Slow decision-making and fragmentation of regulatory systems, as well as complex approval processes, add uncertainty to operations and both deter local entrepreneurship and foreign investment (Ahmed and Ammad, 2021). The problems are aggravated by the issue of political instability, which provides uncertainty in policy execution and increases a risk premium among investors (Rizvi, 2019). These domestic governance restrictions can counter part of the possible benefits of diverted flows of trade and investment. It is necessary to remedy these bottlenecks by reforming the energy sector, ensuring regulatory easing and sound policy frameworks and transform the regional opportunities into sustainable industrial and economic developments.

7.2 Regional Security and Perception Risks

The confidence of investors in Pakistan is a delicate matter that is receptive to security issues in the region and geopolitical outlooks. The closeness to conflict regions, former experiences with politics with India, as well as transnational terrorism risks, increases the perception of political risk, thus discourages foreign direct investment as well as long-term partnerships (Busse and Hefeker, 2005). Even industries that

have good fundamentals like manufacturing and services can be hit by the spillover effects of instability in the region particularly due to disruptions in trade and delays in the supply chain. Instability perceptions also affect the risk ratings by credit rating agencies, insurance companies, and multinational organizations which would increase the cost of financing. The key to addressing this risk of perception is to actively court foreign investors, open security guarantees, and be included in regional economic and connection programs that make them feel secure and reliable.

7.3 Policy Coordination and Capacity Gaps

The success of the possible benefits of the selective isolation of India requires a consistent industrial policy and effective intergovernmental

cooperation. The policy environment in Pakistan is highly fragmented with federal and provincial governments having overlapping or competing goals which undermines the effectiveness of incentives, industrial clustering and enforcement of SEZs (Farole and Akinci, 2011). Poor coordination reduces the dynamicity of the country to respond to exogenous opportunities, i.e. redirected FDI or diversification of the supply chain. Further, regulatory agencies, trade facilitation organisations as well as investment promotion boards have institutional deficiencies that restrain timely implementation of policies. These loopholes need to be closed by means of better governance, improved decision making and capacity building to make sure that the opportunities presented by the outside world can result in sustainable industrial development.

Table 4

Constraints vs Policy Responses

Constraint	Economic Impact	Recommended Policy
Energy shortages	High costs	Power sector reform
Governance gaps	Investor uncertainty	Regulatory streamlining
Security perception	Risk premium	Economic diplomacy

8. Policy Recommendations

8.1 Short-Term Policy Interventions

It is important to mention that the short-term policy interventions may be divided into various categories. In particular, it is necessary to note that the short-term policy interventions can be classified into several categories.

To capitalize on the region changes fast, Pakistan needs to pay attention to export facilitation and reforming the investment climate, which would help Pakistan to take advantage of the situation in the short term. Simple customs procedures, facilitation of export documents, and the promotion of digital trade platforms may make the economy more competitive in the non-traditional markets (World Bank, 2023). At the same time, reforms of the investment environment, including a decline in the bureaucratic hold-ups, solidification of property rights, and the provision of special incentives in key sectors can capture diverted foreign direct investment by companies

that are looking at alternatives to India (Farole and Akinci, 2011). The measures offer short term avenues of converting external opportunities into tangible economic benefits.

8.2 Medium- to Long-Term Industrial Strategy

Medium-long term plans must be oriented at sustainable industrialization, modernization of technology and development of skills in order to achieve long term competitiveness. Vocational training and tertiary education investments in relation to the needs of the sector (IT, engineering, pharmaceuticals, and others) can promote labor productivity and consumption of technology (Nishat and Khan, 2022). At the same time, the industrial capacities can be improved by promoting research and development, supporting the creation of ecosystems of innovation, and introducing digital technologies into the manufacturing and services (Gereffi, 2020). Export credibility and resilience can be enhanced

by sustainable industrialization practices such as energy efficiency, green production and industrial parks that are environmentally compliant. The presence of coordinated policy design between the federal and provincial agencies can help make sure that long-term strategies can be effectively implemented and they are adjusted to the regional and global economic trends.

Pakistan ought to enhance regional and international economic diplomacy in order to gain access and inflow to the market and investments. Bilateral and preferential agreements and proactive trade diplomacy can diversify the markets, and limit the partner reliance (Baldwin, 2020). The presence of strategic economic relationships, especially with the Gulf states, China, and the Southeast Asian economies, will help to increase the investment in infrastructure, the transfer of technologies, and integration into the supply chain. The combined diplomatic tactics along with domestic policy changes enhance the capacity of Pakistan to turn the selective isolation of India into long term regional and global economic benefits.

8.3 Regional and Global Economic Diplomacy

This paper points out that the discriminating international isolation of India, which is occasioned by strategic tensions, trade protectionism, restriction on the regulations and image of the country gives Pakistan structural openings in the manufacturing, services and regional connectivity. By taking advantage of the redirected foreign investment, diversification of supply chains and non-traditional export markets, Pakistan can capitalize on SEZs, industrial clustering, and human capital advantages (Antràs, 2015; World Bank, 2023). Nonetheless, structural constraints in the country, inefficiencies in governance, and security threats in the region might not allow the complete exploitation of these opportunities. All in all, the discussion reveals that a set of external geopolitical changes when managed in a strategic manner can help build up the industrial base, economic resilience, and long-term strategic autonomy of Pakistan.

9. Conclusion and Future Research Directions

9.1 Summary of Key Findings

This study highlights that India's selective international isolation—driven by strategic frictions, trade protectionism, regulatory constraints, and reputational challenges—creates structural opportunities for Pakistan in manufacturing, services, and regional connectivity. Pakistan can capitalize on redirected foreign investment, supply chain diversification, and non-traditional export markets while leveraging SEZs, industrial clustering, and human capital advantages (Antràs, 2015; World Bank, 2023). However, domestic structural constraints, governance inefficiencies, and regional security risks may limit the full realization of these opportunities. Overall, the analysis underscores that external geopolitical shifts, if strategically managed, can strengthen Pakistan's industrial base, economic resilience, and long-term strategic autonomy.

9.2 Future Research Directions

The future studies must also consider the use of comparative frameworks to examine the impact of the selective international isolation of leading regional economies on the neighboring states. The generalizable mechanisms of trade diversion, industrial upgrading, and investment relocation can be detected through cross-regional studies, the South Asia and the East Asia or Eastern Europe (Baldwin, 2020). The industry-specific research on manufacturing, pharmaceutical, IT, and services would give a more detailed understanding of the role of policy, infrastructure, and human capital as the mediator of opportunity capture. The persistence of such effects can also be explained with the help of longitudinal studies that monitor changes in supply chains and flows of FDI. The study will contribute to the development of theoretical knowledge and will be used in the development of the evidence-based industrial and economic policy in Pakistan and other economies of this kind.

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