

PAKISTAN'S RELATIONS WITH INDIA: BEYOND KASHMIR?

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PAKISTAN'S RELATIONS WITH INDIA: BEYOND KASHMIR?

EXECUTIVE SUMMARY AND RECOMMENDATIONS

In March 2011, the Pakistan Peoples Party (PPP)-led government resumed the composite dialogue with India, with the rapid pace of its economic liberalisation program demonstrating political will to normalise bilateral relations. The November 2011 decision to grant Most Favoured Nation (MFN) status to India by the end of 2012 is not merely an economic concession but also a significant political gesture. Departing from Pakistan's traditional position, the democratic government no longer insists on linking normalisation of relations with resolution of the Kashmir dispute. India no longer insists on making such normalisation conditional on demonstrable Pakistani efforts to rein in India-oriented jihadi groups, particularly the Lashkar-e-Tayyaba (LeT), responsible for the 2008 Mumbai attacks and hence suspension of the composite dialogue. The two countries need to build on what they have achieved, notably in promising economic areas, to overcome still serious suspicion among hardliners in their security elites and sustain a process that is the best chance they have had for bilateral peace and regional stability.

Within Pakistan, the normalisation process enjoys broad political support, including from the Pakistan Muslim League (Nawaz, PML-N), the largest opposition party. Viewing liberalised trade with India as in Pakistan's economic interest, the PML-N also believes that broader economic ties would provide a more conducive environment to address longstanding disputes like Kashmir.

Liberalised trade, stronger commercial links and deeper bilateral economic investment would strengthen moderate forces in Pakistan's government, political parties, business community and civil society. Yet, an effective integration of the two economies would only be possible if Pakistani and Indian traders, business representatives and average citizens could travel more freely across borders. For this, the stringent visa regime must be relaxed, including by significantly reducing processing times, granting multiple-entry visas, eliminating police reporting requirements and removing limits on cities authorised and the obligation for entry and exit from the same point.

However, Pakistan's ability to broaden engagement with India and move beyond Kashmir depends on a sustained democratic transition, with elected leaders gaining control

over foreign and security policy from the military. Pakistan must also counter anti-India oriented, military-backed extremist groups. These include the LeT – banned after the 2011 attacks on the Indian parliament but re-emerging as the Jamaat-ud-Dawa (JD) – as well as the Jaish-e-Mohammad and similarly aligned outfits. A powerful military, deeply hostile towards India, still supports such groups and backs the Pakistan Defence Council (PDC, Defa-e-Pakistan Council), a new alliance of jihadi outfits and radical Islamic and other parties aligned with the military that seeks to derail the dialogue process.

Within India, with suspicions of Pakistani intentions still high, Prime Minister Manmohan Singh has limited political support for talks that do not prioritise the terrorist threat. Another Mumbai-style attack by a Pakistan-based jihadi group would make such a dialogue untenable. It could also provoke a military confrontation between the two nuclear-armed neighbours. Meanwhile New Delhi's heavy-handed suppression of dissent and large military footprint in Jammu and Kashmir (J&K) alienates Kashmiris, undermines Pakistani constituencies for peace and emboldens jihadi groups and hardliners in the military and civil bureaucracies.

There are numerous other impediments. Water disputes, for example, could place the Indus Waters Treaty (IWT) of 1960, which has successfully regulated the distribution of a precious resource between the two countries for over five decades, under greater strain. India, with its larger population and mushrooming energy requirements, uses much more of the shared waters, and its domestic needs are rising, while Pakistan depends increasingly on them for its agriculture. With India constructing several dams in the Indus River Basin, the Pakistani military and jihadi groups now identify water disputes as a core issue, along with Kashmir, that must be resolved if relations are to be normalised.

RECOMMENDATIONS

To build on the momentum of, and demonstrate commitment to, the dialogue process

To the Government of Pakistan:

1. Implement its pledge to grant MFN status to India by the end of 2012.
2. Punish those involved in the 2008 Mumbai attacks, communicating any challenges to trials of the accused or related legal processes, including military interference, to Indian counterparts.
3. Act against banned groups that operate freely and against any groups and individuals calling for jihad against India, invoking laws against incitement to violence.
4. Take action against all militant groups, including India- and Afghanistan-oriented jihadi outfits.

To the Government of India:

5. Respond to the above steps by:
 - a) acknowledging that non-tariff barriers (NTBs) are a legitimate Pakistani grievance and ensuring that Pakistani exporters have unimpeded access to the Indian market under the MFN regime; and
 - b) repealing the Armed Forces Special Powers Act (AFSPA) and other draconian laws, replacing a military-led counter-insurgency approach in Jammu and Kashmir (J&K) with accountable policing and holding a meaningful dialogue with all Kashmiri groups.

To the Governments of Pakistan and India:

6. Grant each other overland transit rights.
7. Relax visa regimes significantly.
8. Focus on short, medium and long-term measures to optimise the use of water resources, going beyond project-related disputes that the IWT can already address.
9. Prioritise cooperation on joint energy-related ventures, such as petroleum product pipelines from India to Pakistan, and assess the feasibility of a bilateral, and at a later stage regional, energy grid.
10. Ensure Kashmiri participation in the dialogue process.

Islamabad/Brussels, 3 May 2012

PAKISTAN'S RELATIONS WITH INDIA: BEYOND KASHMIR?

I. BILATERAL RELATIONS

A. TWO STEPS FORWARD, ONE STEP BACK

For over six decades, bilateral relations between Pakistan and India have been shadowed by the Kashmir dispute. Pakistan's official stance on the issue has not wavered: the former princely state of Jammu and Kashmir is a disputed territory, parts of which India occupies illegally; implementation of a UN-mandated "free and impartial plebiscite" that gives Kashmiris the right to choose between Pakistan or India is the only acceptable solution.¹ Officially, the PPP-led coalition government espouses this position,² as do all other mainstream political parties, including Nawaz Sharif's PML-N.

In Pakistan's official discourse, Kashmir's unresolved status is the root cause of tensions with India; other issues, such as trade barriers, travel restrictions and water disputes, are mere irritants that will disappear once this central dispute is resolved.³ In reality, however, policy on Kashmir is far more complex and shaped by various internal and external constraints and compulsions. Domestically, Kashmir has been used as the main rationale for a range of domestic and foreign policy choices, including the mili-

tary's disproportionate role in political life and share of national resources; its patronage of India-oriented jihadi proxies; and its quest for dominance in Afghanistan, expressed through support for Afghan insurgents and often justified on the grounds of the "Indian threat".⁴ Kashmir policy is also moderated according to political developments within J&K, as well as the overall state of bilateral relations with India.

Domestic and external imperatives have often resulted in modifying the official policy on Kashmir. After Pakistan's defeat in the 1971 war with India, Zulfikar Ali Bhutto's PPP government, for example, concluded the Simla Agreement with Indira Gandhi's government, accepting the sanctity of the Line of Control (LOC) without abandoning Pakistan's traditional position.⁵ During the democratic interlude of the 1990s, Benazir Bhutto's and Nawaz Sharif's governments engaged constructively with India on security issues, including Kashmir, but their efforts were stymied by a military unwilling to relinquish its grip over policy toward India in general and toward Kashmir more specifically.

Bhutto's first government (1988-1990) took steps to normalise relations with India by terminating support to Sikh insurgents in Indian Punjab and establishing confidence-building measures (CBMs) on security matters with her counterpart, Rajiv Gandhi. These included an agreement on exchanging lists of and prohibiting attacks on each other's nuclear installations. The military, however, launched a parallel policy of supporting Pakistan-based, Kashmir-oriented militants to exploit a home-grown insurgency in J&K.⁶ Dubbing her government a "security risk" for its

¹ For previous Crisis Group analysis of Pakistan's relations with India in the context of the Kashmir dispute, see Asia Briefings N°106, *Steps Towards Peace: Putting Kashmiris First*, 3 June 2010; and N°51, *India, Pakistan and Kashmir: Stabilising a Cold Peace*, 15 June 2006; and Asia Reports N°79, *India/Pakistan Relations and Kashmir: Steps Towards Peace*, 24 June 2004; N°70, *Kashmir: Learning from the Past*, 4 December 2003; N°69, *Kashmir: The View From New Delhi*, 4 December 2003; N°68, *Kashmir: The View From Islamabad*, 4 December 2003; N°41, *Kashmir: The View From Srinagar*, 21 November 2002; and N°35, *Kashmir: Confrontation and Miscalculation*, 11 July 2002.

² For example, on 5 February 2012 (celebrated annually as Kashmir Solidarity Day), Prime Minister Yousuf Raza Gilani, calling Kashmir the cornerstone of Pakistan's foreign policy, expressed his government's continued commitment to providing "moral, political and diplomatic support" to Kashmiris. "Gone are the days when individuals made foreign policy: Gilani", *The News*, 7 February 2012.

³ Crisis Group Report, *Kashmir: The View From Islamabad*, op. cit., p. 1.

⁴ Crisis Group Asia Report N°221, *Talking about Talks: Toward a Political Settlement in Afghanistan*, 26 March 2012, p. 11.

⁵ The 2 June 1972 Simla agreement stipulates: "In Jammu and Kashmir, the line of control resulting from the ceasefire of 17 December 1971 shall be respected by both sides without prejudice to the recognised position of either side. Neither side shall seek to alter it unilaterally, irrespective of mutual differences and legal interpretations. Both sides further undertake to refrain from threat or the use of force in violation of this line". Victoria Schofield, *Kashmir in Conflict: India, Pakistan and the Unfinished War* (London, 2000), p. 117.

⁶ Crisis Group Report, *Kashmir: The View From Islamabad*, op. cit., p. 18.

overtures to India, Bhutto was ousted by the president, acting at the military's behest, in November 1990.

Nawaz Sharif's most significant step towards bilateral rapprochement came during his second tenure, when he signed the Lahore declaration with his Indian counterpart Atal Bihari Vajpayee, who had accepted an invitation to visit Pakistan on the inaugural journey of a bus service connecting New Delhi to Lahore. The two countries agreed to "intensify their efforts to resolve all issues, including the issue of Jammu and Kashmir"; to "refrain from intervention and interference in each other's internal affairs"; and to "reaffirm their condemnation of terrorism in all its forms and manifestations and their determination to combat this menace".⁷

As with Bhutto's, Sharif's efforts to make peace with India were scuttled by the military, most blatantly through its incursion across the LOC into Kargil in May 1999. This provoked a clash that lasted until July and was defused before it escalated into all-out war only through U.S. mediation and pressure. Amid calls within and outside parliament for the military leadership to be held accountable for the Kargil misadventure, the army chief, Pervez Musharraf, ousted Sharif's government in the October 1999 coup.⁸ Summarising the PML-N's current stance on Kashmir, a senior party member said, "Nawaz Sharif has always felt deeply betrayed by Kargil. It was a major opportunity lost [for peace with India]. Now we want to resume where we left off in the late 1990s".⁹

In contrast to the flexibility displayed by civilian leaders towards India, military regimes have adopted a hardline posture. The military's Kashmir policy is dictated by institutional preferences and past experience. While animosity is shaped by a history of war and India's control over J&K, the Indian threat is also often used to justify control over resources and domestic political interventions.¹⁰ Under Musharraf (1999-2008), the Kargil debacle's architect, Kashmir again became a flashpoint that brought the countries to the brink of war, following the December 2001 attack on India's parliament by the Lashkar-e-Tayyaba (LeT) and Jaish-e-Mohammad.¹¹ By 2004, however, as

unrest in India-administered Kashmir subsided, and Musharraf pledged to curb cross-LOC infiltration by militants, relations appeared to normalise and a "composite dialogue" on all contentious issues, was launched.¹² Over three years, in addition to Kashmir, talks were held on nuclear CBMs, territorial disputes over the Siachen Glacier, Wullar Barrage and Sir Creek, terrorism and drug-trafficking, economic and cultural cooperation and exchanges.

To convince the international community that he was serious in pursuing peace with India through a negotiated settlement of Kashmir, Musharraf expressed his willingness to forego Pakistan's insistence on settling the dispute through UN resolutions, inviting India to join him in devising more imaginative solutions.¹³ The composite dialogue, however, failed to seriously address India-Pakistan trade, as military calculations and territorial claims still trumped the potential economic benefits of improved ties. The Musharraf regime refused to renounce Pakistan's territorial claims over Kashmir, rejected Kashmir's status under the Indian constitution and, more significantly, despite public commitments to rein in all India-oriented jihadi groups, continued to back such organisations. These included the LeT and Jaish-e-Mohammad, which were banned in 2002 but allowed to re-emerge and operate freely under changed names.¹⁴

B. DEMOCRATIC TRANSITION AND THE COMPOSITE DIALOGUE

Musharraf's sole constituency was a military establishment that to this day remains deeply hostile to India. It retains the belief that a proxy war in Kashmir is the only way that India can be pressured into making concessions on issues

and the second during the Yahya regime (1971). Pakistan and India also came to the brink of war in 1986-1987 during the Zia regime. Lashkar-e-Tayyaba was formed under Hafiz Saeed's leadership, with military support, in 1990. Jaish-e-Mohammad was formed in February 2000, with the backing of the military's intelligence agencies. See Crisis Group Asia Reports, N°164, *Pakistan: The Militant Jihadi Challenge*, 13 March 2009; and *Kashmir: Confrontation and Miscalculation*, op. cit.

¹² Meeting on the margins of a South Asian Association for Regional Cooperation (SAARC) summit in Islamabad in January 2004, Indian Prime Minister Atal Bihari Vajpayee and Pakistani President-cum-army chief Pervez Musharraf agreed to resume diplomatic exchanges stalled since the December 2001 attack on the Indian parliament and its fallout in 2002, and to peacefully resolve all contentious issues, including Kashmir.

¹³ One option proposed by Musharraf involved a three-phase solution; seven regions based along ethnic and geographic divisions would be identified in the first phase; each would be demilitarised in the second phase; and their legal and constitutional status would be settled once and for all in the third and final phase.

¹⁴ After the 2002 ban, Lashkar-e-Tayyaba re-emerged as Jamaat-ud-Dawa and Jaish-e-Mohammad as Khaddam-ul-Islam.

⁷ Text of the Lahore Declaration, February 1999, www.usip.org/files/file/resources/collections/peaceagreements/ip_Lahore19990221.pdf.

⁸ For more on the military's instigation of the Kargil conflict, see Crisis Group Report, *Kashmir: Confrontation and Miscalculation*, op. cit., pp. 1-2.

⁹ Crisis Group interview, PML-N Central Working Committee member and member, National Assembly (MNA), Khawaja Mohammad Asif, Islamabad, 21 March 2012.

¹⁰ Crisis Group Report, *Kashmir: The View From Islamabad*, op. cit.

¹¹ This followed earlier military adventurism, with Pakistan fighting two wars with India, first during the Ayub regime (1965)

that are vital to Pakistan's national security. After Musharraf's ouster, during the ongoing democratic transition, the military has shown itself averse to ceding control of foreign and security policy, particularly with regards to India, to the civilian leadership. But the PPP, with PML-N support, has already begun to meaningfully reshape relations. With the constituencies of the largest parties supporting trade and normalisation, there is now greater potential for the ongoing dialogue, if sustained, to result in peace.

The PPP, which formed a coalition government after the February 2008 elections, came to power with the electoral pledge of pursuing a composite dialogue process with India, including on Kashmir and other issues, without allowing "lack of progress on one agenda to impede progress on the other". Resolving to "replace the infrastructure of conflict with the architecture of peace", it declared that peaceful bilateral relations were "imperative" for Pakistan's and indeed South Asia's prosperity.¹⁵ After the electoral victory, the PPP co-chairperson, now President Asif Ali Zardari, reaffirmed his party's support for Kashmiris but also stressed that Pakistan's relations with India should no longer be tied solely to the resolution of the dispute.¹⁶

Heading the PPP's main rival party, Nawaz Sharif, an ethnic Kashmiri whose PML-N now heads the provincial government in Punjab, Pakistan's largest province and the military's main recruiting ground, has been equally supportive of peace with India. Addressing a seminar organised by the South Asian Free Media Association in August 2011, he declared that "India and Pakistan have the same culture ... worship the same God, and speak the same language", and expressed the hope that two countries would "compete in the realm of economics [rather] than in armaments".¹⁷

With broad support from the political opposition, the PPP-led government thus advanced the peace agenda, but its efforts to resume the composite dialogue came to an abrupt halt following the 26 November 2008 terror attacks in Mumbai. Foreign Minister Shah Mahmood Qureshi was in New Delhi when the attacks occurred. Suspending all talks with Pakistan, Manmohan Singh's government accused the LeT/JD, with the backing of the Inter-Services Intelligence Directorate (ISI), the military's main intelligence arm.¹⁸ Responding to India's request, the UN Secu-

urity Council declared that the JD was the LeT's front organisation and included it in the list of sanctioned terror groups on 10 December. Although Pakistan at first denied that the Mumbai attackers were Pakistani, it banned the JD the day after the UN action and placed Hafiz Saeed, its founder, under house arrest. However, the Lahore High Court released Saeed in October 2009, dismissing all cases against him for lack of evidence after rejecting evidence provided by India on his involvement in the Mumbai attacks. In the absence of an official notification of the 2008 ban, the JD was left legally free to function in the country.¹⁹

Through most of 2009, New Delhi insisted that it would resume the composite dialogue only if Pakistan proved willing to bring the perpetrators of the Mumbai attacks to justice. Home Minister P. Chidambaram demanded "cast iron guarantees" from Islamabad that "no state actors or non-state ones will be allowed to use Pakistani soil or sources to launch an attack on India".²⁰ Yet, realising that the PPP government's inability to act against the jihadi organisations was more the result of a yet fragile transition than the lack of political will, Prime Minister Singh responded positively to Islamabad's efforts to resume the dialogue process.

Meeting on the sidelines of the South Asian Association for Regional Cooperation (SAARC) summit in Bhutan in April 2010, he and his Pakistani counterpart, Prime Minister Yousuf Raza Gilani, agreed to "think afresh" towards a "substantive dialogue".²¹ Talks about talks continued for almost a year, and the composite dialogue finally resumed in March 2011, when Gilani accepted Singh's invitation to attend the World Cup cricket match between Pakistan and India.²² Since then, while talks in May 2011, held after a three-year hiatus, did not break the deadlock over the Siachen Glacier or the Sir Creek waterway disputes, the two governments have addressed a range of key issues,

Pakistan, 18 April 2005; N°73, *Unfulfilled Promises: Pakistan's Failure to Tackle Extremism*, 16 January 2004; N°49, *Pakistan: The Mullahs and the Military*, 20 March 2003; and N°36, *Pakistan: Madrasas, Extremism and the Military*, 29 July 2002.

¹⁸ Naqib Hamid, "Defending the 'land of the pure'", *Daily Times*, 31 January 2012.

¹⁹ "Complete profile of Hafiz Saeed", *Daily Times*, 7 April 2012; "Defense of Pakistan Conference: Jamaat-ud-Dawa violates rules for rally", *The Express Tribune*, 18 December 2011. For more on the failure of Pakistan's criminal justice system to produce convictions in terrorism-related cases, see Crisis Group Asia Report N°196, *Reforming Pakistan's Criminal Justice System*, 6 December 2010.

²⁰ "India to present evidence against Pakistan", Reuters, 4 January 2009.

²¹ Subhajt Roy, "Thaw in Thimpu", *The Indian Express*, 30 April 2010.

²² India won the match by 29 runs in Mohali (Punjab) on 30 March 2011.

¹⁵ PPP Manifesto 2008, p. 20, <http://www.ppp.org.pk/manifestos/2008.pdf>.

¹⁶ Myra Macdonald, "Zardari on Kashmir – Realpolitik or betrayal?", Reuters, 3 March 2008.

¹⁷ Khaled Ahmed, "The lonely Nawaz Sharif", *Newsweek Pakistan*, 2 September 2009.

¹⁸ Tom Wright, "India strengthens accusation of ISI Mumbai link", *The Wall Street Journal*, 10 May 2011. For more analysis on the Pakistani military's support to extremist groups and radical Islamic parties, see Crisis Group Asia Reports, *The Militant Jihadi Challenge*, op. cit.; N°95, *The State of Sectarianism in*

including trade, communications, water, the exchange of prisoners, border security and energy cooperation.

Given the nascent stage of the democratic transition and the military's pushback, Pakistan's political leadership appears as yet incapable to take the initiative on security-related and territorial disputes, particularly Kashmir.²³ However, its willingness to prioritise deepening economic links with India, rather than focus on resolving an intractable dispute, has enabled a broader and potentially more productive dialogue than those of the past. By refocusing the bilateral talks to economic cooperation and ensuring domestic buy-in, the PPP government has managed to put the normalisation process on fast track. For this, the support of the Pakistani business community has been critical. As an editorial in a major English-language daily put it, "Islamabad would not have been able to move so swiftly if it did not enjoy the full support of Pakistani businessmen".²⁴

In addition to official talks, there are numerous non-governmental efforts to normalise relations. Launched by two leading Indian and Pakistani media enterprises in January 2010, *The Times of India* and the Jang Group respectively, the Aman ki Asha (Hope for Peace) initiative promotes a range of activities, from closed-door discussions on political issues such as Kashmir, intelligence sharing and water to cultural programs such as concerts and literary shows. In December 2010, an economic conference of Pakistani and Indian businessmen, held under its auspices outlined six sectors with the greatest potential for cooperation – health, education and skills training, information technology, energy, agriculture and textiles – and formed committees of CEOs of major companies to explore options

for increased cooperation for each.²⁵ Another economic conference will be held in Lahore on 7-8 May 2012.²⁶

²³ "India-Pakistan defence secretary-level talks on Siachen fail", *India Today*, 31 May 2011; "Sir Creek talks inconclusive", *The Nation*, 22 May 2011. Fighting for control of the Siachen Glacier dates back to 1984, with a ceasefire reached in 2003. Although not a declared war, it is still the longest-running armed conflict between the two countries in one of the highest battlefields in the world, where most casualties are weather-related. Following the deaths of 140, including 129 soldiers, in an avalanche at an army base, situated just below Siachen Glacier, on 7 April 2012, PML-N chief Nawaz Sharif called on Pakistan and India to withdraw troops from Siachen and demanded that Pakistan take the initiative to end the conflict. Shabbir Mir, "Pakistan should lead Siachen troop pullout: Nawaz", *The Express Tribune*, 18 April 2012. India and Pakistan have also failed to agree on delimiting their maritime boundary in the Sir Creek waterway running along the Rann of Kutch, a marshy area between India's Gujarat state and Pakistan's Sindh province. Pakistan insists that the whole of Sir Creek falls within its territory while India contends that the boundary should be drawn in the middle of the creek.

²⁴ "Trade boost", *Dawn*, 2 March 2012.

²⁵ Beena Sarwar, "Aman ki Asha two years on: driving the normalisation process", *The News*, 1 January 2012.

²⁶ "The 'trade for peace' train steams ahead", *The News*, 26 April 2012. Pakistan Business Council and the Confederation of Indian Industries, in collaboration with Aman ki Asha, have agreed to hold annual business conferences alternatively in Pakistan and India. The memorandum of understanding signed in April 2012 said that the parties would "take up policy issues with their respective governments with a view to addressing problems and bottlenecks, non-tariff and para-tariff barriers in the promotion of trade and economic cooperation". "Pak-India business conferences on the anvil", *The News*, 18 April 2012.

II. TRADING FOR PEACE

A. MOVING FORWARD

Despite geographic proximity and the resultant potential for reduced transportation costs, as well as trade complementarity for a range of goods, Pakistan's trade with India is only 1 per cent of its total global trade. It takes three forms: direct, indirect and illegal. Direct bilateral trade has increased substantially in recent years, to \$2.6 billion in 2010-2011, but remains far below an estimated potential of \$40 billion.²⁷ Exports to India increased from \$275.9 million in 2009-2010 to \$332.5 million in 2010-2011, but even though it benefits from MFN status, this is only 0.09 per cent of total Indian imports. India's exports to Pakistan rose from \$1.5 billion in 2009-2010 to \$2.3 billion in 2010-2011, a mere 0.93 per cent of the country's total exports.²⁸

Estimates of indirect trade through third countries such as the United Arab Emirates, Singapore, Iran and Afghanistan range anywhere between \$0.5 billion to \$10 billion a year.²⁹ Illegal trade or smuggling, which is carried out through the connivance of "crooked traders and corrupt customs officials",³⁰ is encouraged by restrictions on imports of specific items, high tariff charges, rigid non-tariff barriers, pilferage in transit trade and "distortions in domestic policies which create an incentive to transport items illegally to neighbouring countries".³¹

With the PPP-led government taking the initiative on broadening economic ties, Pakistan's commerce minister and his Indian counterpart agreed in New Delhi in September 2011 to more than double bilateral trade within three years, to around \$6 billion, and to cooperate to establish preferential trade relations under the framework of the 2006 South Asian Free Trade Agreement (SAFTA).³² On 2 November 2011, the Gilani cabinet decided to move toward granting MFN status to India under World Trade Organisa-

tion (WTO) rules, which mandate that a member treat all trading partners equally. In addition to potentially opening trade, this major political gesture by the elected government gave a much needed boost to New Delhi's confidence in the prospects for improved bilateral ties.

Meeting in New Delhi that same month, the two commerce secretaries issued a joint statement that set out a number of objectives to be achieved within a set timeframe. In a sequential approach to full normalisation of trade relations, Pakistan, in the first stage, would replace the existing "positive list" of items that it could import from India with a "negative list" of items that would be excluded. In the second stage, by the end of 2012, Pakistan would phase out the negative list, formally granting India MFN status.³³

In addition to their WTO memberships, Pakistan and India were among the original signatories to the General Agreement on Tariffs and Trade (GATT), the covenant that "enshrined the trade-liberalising MFN principle" and was the forerunner of the WTO.³⁴ For several decades, however, political differences prevented both countries from fulfilling their GATT obligations toward each other. India finally granted Pakistan MFN status in 1996, but Islamabad, wedded to its Kashmir-first policy, refused to reciprocate and, violating WTO rules, maintained a limited "positive list" of items that could be imported from its neighbour.

From 42 items in 1986, the positive list expanded to 1,075 items by 2006³⁵ and presently includes almost 2,000 items.³⁶ Nevertheless, according to Ishrat Hussain, a former governor of the State Bank of Pakistan, the very concept of a positive list has "inhibited trade, undermined confidence and violated Pakistan's international obligations under the WTO and its regional obligations under SAFTA".³⁷ By maintaining the positive list, the commerce

²⁷ "Pak-India trade still a fraction of \$40 billion potential", *The Express Tribune*, 13 March 2012; "Liberal visa regime for India, Pakistan business travel soon", *The Times of India*, 26 November 2011.

²⁸ "Export Import Data Bank", commerce department, Government of India, 10 January 2012, <http://commerce.nic.in/eidb/iecnt.asp>.

²⁹ Zareen Fatima Naqvi, "Pakistan-India Trade Potential and Issues", *The Lahore Journal of Economics*, vol. 14, September 2009.

³⁰ Crisis Group interview, customs official, Pakistan's border with India, Wagah, Lahore, 9 February 2012.

³¹ Sajjad Ashraf, "India and Pakistan – The Economic Stand-Off", Institute of South Asian Studies (ISAS) working paper no. 57, 18 May 2009, p. 4.

³² "Pakistan to Normalise Trade Relations with India", International Centre for Trade and Sustainable Development, vol. 15, no. 38, 9 November 2011.

³³ "Joint Statement of the 6th Round of Talks on Commercial and Economic Cooperation between Commerce Secretaries of India and Pakistan", commerce ministry, Government of Pakistan, Islamabad, 15 November 2011.

³⁴ Abid Hussain Imam, "What the MFN means", *Dawn*, 7 November 2011.

³⁵ Nisha Taneja, "India-Pakistan Trade Possibilities and Non-Tariff Barriers", working paper no. 20, Indian Council for Research on International Economic Relations, October 2007, pp. 1-2.

³⁶ Aditi Phadnis, "Bringing down barriers: Phased expansion of India trade from February", *The Express Tribune*, 15 November 2011.

³⁷ Crisis Group interview, Karachi, 16 January 2012.

ministry estimates, the country is currently losing \$300 million-\$700 million annually in trade.³⁸

After Pakistan finally accords India full MFN status, formal trade, instead of informal trading channels, will provide major benefits to the economy. Even more significantly, the resultant political and diplomatic momentum will benefit the civilian leadership and the democratic transition, making it more difficult for spoilers to disrupt the normalisation process. "We have been assured that after MFN [status is granted], other liberalisation will automatically follow", said an Indian commerce ministry official. "I would be very surprised if Pakistan were to pull back after all this progress, including establishing a concrete timeline. It would have international ramifications. So, barring catastrophe, we have reached a new stage of normalisation".³⁹

New Delhi has not insisted on tariff reciprocity. It reduced peak tariffs on Pakistani goods from 11 per cent to 8 per cent as of 1 January 2012 under SAFTA, and these are scheduled to go to 5 per cent by 1 January 2013.⁴⁰ However, Pakistan's main grievances with respect to bilateral trade are yet to be addressed, namely an array of non-tariff barriers (NTBs), including rigorous application of product-quality standards and complicated customs procedures. These, many Pakistani officials and businessmen argue, make it extremely difficult for Pakistani imports to compete in the Indian market.

Indian commerce ministry officials either deny that NTBs exist or insist that Pakistan exaggerates their impact.⁴¹ However, expressing a commonly shared Pakistani view, a senior member of the Federation of Pakistan Chambers of Commerce and Industry (FPCCI) called India's trade regime "harsh and excruciatingly bureaucratic", adding that "simply granting MFN status to each other will not amount to much unless non-trade barriers are removed".⁴² There are "as many as 24 Indian standard-setting bodies at the centre and state levels, multiple rules and regulations and a diverse array of certifying agencies", said a former president of the Lahore Chamber of Commerce and Industry. "This makes it very difficult for foreign exporters to know who to talk to or how to get things done".⁴³

While Pakistani commerce ministry officials acknowledge that India maintains no "Pakistan-specific" NTBs,⁴⁴ many Pakistani traders contend that their two major export items – textiles and agricultural products – are subject to the most unreasonable tariff and non-tariff barriers.⁴⁵ A report prepared by the Indian Council for Research on International Economic Relations (ICRIER) in 2007 agreed, concluding that while India's application of technical barriers to trade and "sanitary and phyto-sanitary" standards was not discriminatory, Pakistani exports were especially affected.

Acknowledging the existence and negative impact of NTBs, particularly on Pakistani agricultural products and cement, a former Indian foreign secretary called for bilateral agreement on mutually acceptable sanitary and technical standards.⁴⁶ It is encouraging that Islamabad and New Delhi have already established a working group to review such barriers to trade liberalisation. The group will also explore potential areas of cooperation, such as power, including a joint energy grid, a joint liquefied natural gas (LNG) pipeline and cooperation on hydropower projects. With energy shortages and water scarcity undermining industrial and agricultural productivity, cooperation in these areas would pay major dividends to Pakistan's economy.

Inadequate transportation routes, weak transportation infrastructure and cumbersome customs procedures, as well as financial bottlenecks resulting from the governments' longstanding refusal to allow their banks to operate on each other's territory, have also impeded bilateral trade. Trade transaction times with India are prolonged and costly, problems that could be mitigated if bank branches were set up in each other's countries; the transportation infrastructure, particularly railway links, expanded and improved; customs procedures eased; and tariffs reduced. Moreover, a highly restrictive visa regime limits market access for many traders. Consular officials on both sides use "tremendous discretionary powers" to allow a select few competitors to "make repeated visits and have access to trade-related information", but in effect discouraging more extensive cross-border trade.⁴⁷

Some of these issues were addressed at the February 2012 meeting of the commerce ministers in Islamabad. Soon after, three agreements were signed, on customs cooperation, mutual recognition and redressal of trade grievances. Agreement was also reached on the two central banks each opening a cross-border branch.⁴⁸ Furthermore, the decision

³⁸ Shahbaz Rana, "MFN status to India: Pakistan proposes safeguards for local industry", *The Express Tribune*, 23 December 2011.

³⁹ Crisis Group interview, New Delhi, November 2011.

⁴⁰ "India to cut tariff lines by 20 per cent under SAARC pact", *The Hindu*, 8 September 2011.

⁴¹ Crisis Group interviews, New Delhi, November 2011.

⁴² Crisis Group interview, Karachi, 17 January 2012.

⁴³ Crisis Group interview, Lahore, 7 February 2012.

⁴⁴ Rana, "MFN status to India", op. cit.

⁴⁵ Crisis Group interviews, officials, Karachi and Lahore Chambers of Commerce and Industry, January-February 2012.

⁴⁶ Crisis Group interview, Shyam Saran, New Delhi, 22 November 2011.

⁴⁷ Taneja, op. cit., p. 23.

⁴⁸ Ibid.

was taken to make the Wagah-Attari border post fully operational by April 2012. The Integrated Customs Post there – the first multi-entry and fully automated one between the countries – is now functional. Inaugurated by the two commerce ministers on 13 April, the trade terminal, with faster clearance facilities, has the potential of increasing the number of cargo trucks from the current 25 a day to around 1,000.⁴⁹ Meetings of expert groups on trade in electricity and petroleum products are also scheduled. This tangible progress has further empowered Pakistani reformers, enabling the Gilani cabinet to approve a negative list of 1,209 items and sanction the gradual phasing out of that list to make way for MFN by the end of the year.⁵⁰

Although reciprocal transit rights would also help to further integrate the economies while accruing revenues to the transit country, perceived security concerns have impeded any such agreement. Under its current transit trade agreement with Kabul, renegotiated and signed in October 2010, Pakistan has, for the first time, allowed post-Taliban Afghanistan access to a land route to export goods to India, but it still denies India the same access for its exports to Afghanistan. New Delhi similarly denies Pakistan transit across its territory to Nepal and Bangladesh.

“A pure economist would say it is silly for India and Pakistan not to grant each other transit, but our governments have not reached the stage of reconciling security concerns with other internal calculations”, said a senior Indian commerce ministry official.⁵¹ Just as Indian security officials evoke the threat of ISI, as well as jihadi, infiltration – including fears that Pakistani and Bangladeshi jihadi groups would more easily merge, Pakistani military officials and their foreign office allies believe that RAW (the Research and Analysis Wing, India’s foreign intelligence agency) agents would enter Pakistani territory if India were granted a transit route to Afghanistan.

There are also some legitimate economic concerns. Some Pakistani political leaders argue that Indian goods exported to Afghanistan are often smuggled back across the porous Durand Line, thus expanding the black market and undermining domestic production.⁵² In India, some influ-

ential lobbies oppose transit rights not just to Pakistan but to other neighbours as well, contending that this provides important political leverage over them. Former Foreign Secretary Shyam Saran strongly disagrees: “Given the volume of goods and services on India’s highways, if we open up transit to everyone, how much do we really lose? So, rather than talk of leverage in a negative sense, let’s talk about the huge good-will and political gains [India would accrue] in the region. But this will require a major policy decision”.⁵³

B. TRADE POTENTIAL

“India-Pakistan trade is a win-win situation”, said former Pakistan State Bank Governor Ishrat Hussain, arguing that even a 10 per cent share of a 300 million-strong Indian middle class market would double the market share of Pakistani companies and businesses.⁵⁴ Shahid Kardar, another former State Bank governor, described bilateral trade liberalisation as a “no-brainer”, economically advantageous to both countries.⁵⁵

Major advantages for the Pakistani as well as the Indian economy include cheaper transportation costs due to shorter distances, making it unnecessary for industries to carry large inventories of raw materials and intermediate goods, thus reducing operation costs. State revenues would also increase if the estimated annual \$1.5 billion in smuggled goods were to flow through official channels. In the longer term, should the process of liberalisation continue, there is potential for enhanced investment, including in joint ventures.

The advantages for the Pakistani economy are quite obviously greater than for its larger and more prosperous neighbour. The normalisation of trade relations with India would “open up a hitherto stalled growth node for the Pakistani economy”, said political economist Asad Sayeed. “Economic growth can take place either through major structural transformation or through trade. Since Pakistan’s economic structure has remained the same for at least the last 40 years, the only way to ensure growth is regional trade and investment”. Following trade liberalisation with India, Sayeed maintained, Pakistan’s two largest industries, textiles and food processing, could penetrate the huge north Indian market, while energy-deficient India would benefit, for instance, by tapping the world’s second largest

⁴⁹ “Integrated Checkpost functional at Attari-Wagah Border”, *India Outlook*, 8 April 2012; Razi Syed, “India-Pakistan trade: Integrated checkpost to enhance trade to \$8 billion”, *Daily Times*, 14 April 2010. See also Rama Lakshmi and Richard Leiby, “India, Pakistan leaders pledge improved relations”, *The Washington Post*, 8 April 2012. The commerce ministers who inaugurated the post were Makhdoom Amin Fahim (Pakistan) and Anand Sharma (India).

⁵⁰ “Federal cabinet approves phasing out of negative list existing between Pakistan, India”, *The Nation*, 29 February 2012.

⁵¹ Crisis Group interview, New Delhi, November 2011.

⁵² Crisis Group interviews, Islamabad, March 2012. The Durand Line demarcated Afghanistan and British India in 1893. It is

recognised by Pakistan but rejected by Afghanistan as the international border. See Crisis Group Asia Report N°175, *Afghanistan: What Now For Refugees?*, 31 August 2009, p. 2.

⁵³ Crisis Group interview, New Delhi, 22 November 2011.

⁵⁴ Crisis Group interview, Karachi, 16 January 2012.

⁵⁵ Crisis Group interview, Lahore, 9 February 2012.

coal reserves, in the Thar region of Pakistan's Sindh province.⁵⁶

"India enjoys an advantage in rice, maize and grains, whereas Pakistan's basmati rice, cotton, citrus [fruits] and mangoes can readily find a market in India", said a former Pakistan State Bank governor, who maintained that his country's agriculture, devoid of the "huge input and other subsidies enjoyed by Indian farmers", has become much more efficient over the last decade and is "extremely well-placed to compete with the Indians".⁵⁷ Moreover, Pakistani farmers would benefit from India's success in raising yields per acre through improvements in seed, irrigation and mechanical technologies.

Such views are shared across the mainstream Pakistani political spectrum. "There is enormous benefit of increased commerce with India, especially given our present economic and energy crisis", said a PML-N member of parliament: "Abject poverty in Pakistan is rising. SAARC has the lowest level of trade and commerce [of any regional economic zone] compared not just to Latin America, North America and the EU, but also Africa, South East Asia and the Pacific region, all of which have immense trade. We have to find ways for greater economic cooperation, without undercutting the Kashmir issue".⁵⁸

Recent concessions have helped win over some among the Pakistani business community still distrustful of Indian intentions. According to a senior commerce ministry official, the business community deeply resented India's WTO opposition to the European Union's 2010 trade concessions package for Pakistan's flood-hit economy. When India dropped those objections, much of this animosity subsided.⁵⁹ Today, opposition within the business and trading community to unrestricted trade with India comes primarily from what a political economist described as "very powerful cartels, all of whom are involved in fixing prices that optimise their profits at the expense of the consumer".⁶⁰

A prominent economist, currently a senior government official, added: "There is still a lot of rent-seeking in the Pakistani economy, so it is not nearly as competitive an economy as India's. Vested interests are trying and will keep trying to oppose trade liberalisation with India".⁶¹ Those likely to be hit hardest by competition from far cheaper Indian goods include the powerful automobile and motorcycle sectors, the pharmaceutical sector and the

domestic steel industry, all of whom advocate a cautious approach towards trade liberalisation not just with India but generally.⁶²

Such opponents of trade liberalisation claim that cheaper Indian goods would irretrievably damage the domestic manufacturing sector. These fears are exaggerated, given that Pakistani industries have survived for decades despite competing against both legally imported and smuggled goods. Moreover, as a former State Bank governor stressed, "if Pakistani exports can compete with Indian exports in international markets, then they can certainly compete with Indian products domestically".⁶³ According to an economist, if automobile manufacturing, pharmaceuticals, heavy engineering and steel lose business to Indian competitors, it would amount to "short-term static losses, which happen when trading with anybody".⁶⁴ These views are shared by political leaders from the ruling party and parliamentary opposition.⁶⁵ A PML-N leader, for example, believes that losses to some non-competitive industries would be compensated by major gains in others, such as cement.⁶⁶

Nor is it economically viable for Pakistan to continue protecting industries that refuse to mature and become more competitive. In any case, compulsions to sustain failing industries are more often political than economic. A senior Pakistani official argued that "the rent-seeking industry will protect its gains at all cost. It is like a spoilt child that, when it kick[s] up a fuss, its parents assure it everything will be okay".⁶⁷ For example, while economic imperatives might dictate the closure of the dysfunctional, state-owned Pakistan Steel Mills, this would entail laying off thousands of workers who form an important constituency for several influential parliamentarians.⁶⁸ The automobile industry benefits from exorbitant regulatory duties imposed on

⁵⁶ Crisis Group interview, Karachi, 18 January 2012.

⁵⁷ Crisis Group interview, Lahore, 9 February 2012.

⁵⁸ Crisis Group interview, Khawaja Mohammad Asif, Islamabad, 21 March 2012.

⁵⁹ Crisis Group telephone interview, 29 March 2012.

⁶⁰ Crisis Group interview, Farrukh Saleem, Islamabad, 24 January 2012.

⁶¹ Crisis Group interview, Islamabad, March 2012.

⁶² An automobile industry representative claimed that the government "keeps denying us a place at the negotiating table with the Indians even as it allows bureaucrats and traders to determine the trade agenda". Crisis Group interview, Lahore, 8 February 2012.

⁶³ Crisis Group interview, Shahid Kardar, Lahore, 9 February 2012.

⁶⁴ Crisis Group interview, Karachi, 18 January 2012.

⁶⁵ Crisis Group interviews, Islamabad and Lahore, March 2012.

⁶⁶ Crisis Group interview, Islamabad, 21 March 2012.

⁶⁷ Crisis Group interview, Islamabad, April 2012.

⁶⁸ From 2009 to 2011, alone, Pakistan Steel Mills incurred a loss of Rs. 49.5 billion (more than \$500 million). In 2011, it received a government bailout package of Rs. 6 billion (\$66 million) to prevent its closure. It has now requested another Rs. 9 billion (\$99 million) bailout. Shahbaz Rana, "Bleeding the country dry: Five public entities lose Rs. 393 billion", *The Express Tribune*, 24 April 2012; Ishrar Khan, "Pakistan Steel Mills seeks another Rs. 9 billion bailout package", *The News*, 11 April 2012; Khaleeq Kiani, "Steel Mills given Rs. 6 billion lifeline", *Dawn*, 11 November 2011.

imported cars, to which WTO obligations do not apply and that would, therefore, remain even if India receives MFN status.

Given Pakistan's significant economic challenges, Islamabad should recognise that such practices undermine innovation, competition and the interests of the ordinary consumer. As former State Bank Governor Shahid Kardar noted, "why should the government continue to protect inefficient industry at the cost of long-suffering consumers? There can be no justification for continuing to punish consumers for the sake of keeping alive industries that refuse to make themselves strong enough to withstand competitive pressures".⁶⁹

C. FACILITATING ECONOMIC COOPERATION

Visa regime changes are vital if Pakistan and India are to reap economic cooperation benefits. A senior Pakistani official argued:

You cannot have movement of goods without movement of people. Tourist trade accounts for a lot of the trade between neighbouring countries. We should not think of trade as just between traders and businesses. Just as important is the woman who comes across, buys a garment and a carpet and takes them back.⁷⁰

The current visa regime imposes severe restrictions on cross-border travel, including long processing times; a single-entry limit; city-specific authorisation, with a three-city limit; police reporting requirements (which can be waived); and the same entry and exit points. The Islamabad-New Delhi dialogue has resulted in some progress, with agreement, at least in principal, to a more liberal regime for the business community; this should be urgently codified. Meanwhile, the governments and business communities on both sides should foster more contacts between potential traders and investors, such as by organising regular exhibitions that could facilitate access, interaction, information sharing and exchange of goods.⁷¹

The ability to cross borders easily would enable potential investors to gauge opportunities, but Pakistan would also have to fundamentally change how it does business. An economist in a senior government post asked:

Locally, nobody is investing in Pakistan, so why would anyone in India do so? For example, we have not built a new hotel in Islamabad for 40 years. This is not because we need someone from India to build us a hotel; it is because the military and civil bureaucracy does not want us to build hotels, because it wants to appropriate the city for itself – for its luxury homes and gardens and clubs.⁷²

This phenomenon goes well beyond Islamabad; much of the valuable real estate in Karachi, for example, is in military-owned cantonment areas and military-controlled housing schemes, while major residential and non-residential estates in Lahore are also controlled or owned by the military and the provincial government. As a result, the official said, "we have killed the retail industry. If we are to change this, if we are to encourage investment, if we are to build a proper infrastructure for business, we will have to improve our tariff regimes, change our zoning laws and building codes and get the military and civil service out of the property business".⁷³

India must ease restrictions on Pakistani investment. Pakistan maintains no barriers to Foreign Direct Investment (FDI) from India, but it remains the only country prevented from investing in India. In April 2012, Trade Minister Anand Sharma announced, at a news conference with his visiting Pakistani counterpart, Makhdoom Amin Fahim: "India has taken an in-principle decision, as part of the process to deepen our economic engagement, to allow foreign direct investment from Pakistan to India". He added: "Procedural requirements [for FDI] are underway. It will be notified soon".⁷⁴ New Delhi should approve this without delay.

Although Pakistan already allows Indian FDI, Indian businesses have been hesitant to invest in Pakistan because of political instability and, especially, insecurity.⁷⁵ A New Delhi-based information technology entrepreneur, for example, said, "we do see a potential market in Pakistan – but we want to hold off and watch the situation ... for a few years before thinking of entering. We want to feel welcome, but also safe".⁷⁶ Such concerns are widespread. Corporate lobbies have distanced themselves from Pakistan more broadly in response to terror attacks, such as in Mumbai, when corporate sponsors lobbied the Indian Premier League (IPL) to bar Pakistani cricketers from

⁶⁹ Crisis Group interview, Lahore, 9 February 2012.

⁷⁰ Crisis Group interview, Islamabad, 21 March 2012.

⁷¹ In April 2012, Pakistani businessmen and entrepreneurs participated in the largest Pakistani trade fair in India, with the Federation for Indian Chambers of Commerce and Industry (FCCI) facilitating 150 business-to-business meetings. S. Akbar Zaidi, "Bordering on hope", *The Indian Express*, 17 April 2012; "Lifestyle exhibition: Pakistani companies look for foothold in India", *The Express Tribune*, 13 April 2012.

⁷² Crisis Group interview, Islamabad, 4 April 2012.

⁷³ Crisis Group interview, Islamabad, 4 April 2012.

⁷⁴ "India to allow direct foreign investment from Pakistan", Reuters, 13 April 2012; "India to allow FDI from Pakistan: Anand Sharma", NDTV, 13 April 2012.

⁷⁵ Crisis Group interviews, business representatives and government officials, New Delhi, November 2011.

⁷⁶ Crisis Group interview, New Delhi, November 2011.

competing in the 2009 season, because they did not want their brand names to be associated with Pakistan.⁷⁷ Ultimately, however, Indians' willingness to do business in and with Pakistan depends on a sustained democratic transition that is essential to the delivery of both political stability and better security.

III. WATER AND ENERGY

The Indus River Basin consists of six shared rivers: Beas, Chenab, Jhelum, Ravi, Sutlej and the Indus. Water distribution between Pakistan and India through these rivers is governed by the Indus Basin Waters Treaty of 1960 (IWT), which gives control of the Indus, Chenab and Jhelum to Pakistan and the remaining three to India. The lower riparian, Pakistan, has access to 80 per cent of the water in the Indus River system while India can use some of the water for farming, drinking and power generation, provided that this does not reduce or delay Pakistan's supply.⁷⁸

While the treaty has survived three wars, it has recently been under strain, because of Pakistan's increased needs for agriculture, which accounts for 23 per cent of its GDP, and India's increasing use of the shared waters. Pursuing hydropower development to meet the demands of a growing economy, a steadily expanding population and mushrooming energy requirements, India is constructing as many as 33 multi-purpose dams in the Indus River Basin.⁷⁹ The most contentious include the Wullar Barrage (also known as the Tulbul Navigation Project), the Kishanganga hydroelectric project and the Baglihar dam.

In 1984, India began construction on a barrage on Wullar Lake in J&K's Baramulla district to make the Jhelum River navigable all year. Pakistan complained that any attempt to block the Jhelum would violate the IWT. While India suspended construction in 1987, it still claims the right to build the barrage but is prepared to negotiate with Pakistan on changes to its design and structure.⁸⁰

Pakistan, however, continues to oppose the Wullar Barrage and any other project that may result in Indian control over waters allocated to it under the IWT. This includes the Kishanganga hydroelectric project, which Pakistan alleges will divert the waters of the Neelum River (where Pakistan is working on the Neelum-Jhelum hydropower project) to the Wullar lake, and the Baglihar dam on the Chenab, whose design Pakistan believes breaches the IWT because it could restrict the Chenab's flow into Pakistan. This disagreement led Pakistan to submit its case to a neutral adjudicator appointed by the World Bank under the IWT, who in 2007 concluded that India's construction

⁷⁸ Ayesha Siddiqi and Marie Lall, "Kashmir – Existing Deadlocks and Emerging Challenges", *South Asia Journal*, issue 3, January 2012.

⁷⁹ "Avoiding Water Wars: Water Scarcity and Central Asia's Growing Importance for Stability in Afghanistan and Pakistan", Staff Report for the U.S. Senate Foreign Relations Committee, 112th Congress, first session, 22 February 2011, p. 9.

⁸⁰ "India has right to build Wullar Barrage: Indian secretary", *The Express Tribune*, 12 May 2011.

⁷⁷ Crisis Group interviews, New Delhi, November 2011.

of the dam was consistent with the IWT but required minor structural modifications, a ruling that Pakistan accepted.⁸¹

Prime Minister Gilani's government is also considering going to the International Court of Arbitration to prevent India's construction of the Nimoo-Bazgo hydropower project on the Suru River (a tributary of the Indus) in Kargil, because it could curtail Indus River flows to Pakistan.⁸² Water from the Indus is more necessary than that of any other river, because of its central role for the agricultural sector, supplying the world's largest contiguous irrigation system, which covers 83 per cent of the country's cultivated land and contributes to almost a quarter of its GDP.⁸³

Pakistan's concerns about the potential depletion of its lower riparian water resources are justifiable. According to a February 2011 report by the U.S. Senate Foreign Relations Committee, while no single Indian dam would affect Pakistan's IWT-guaranteed access to water, "the cumulative effect of these projects could give India the ability to store enough water to limit the supply to Pakistan at crucial moments in the growing season".⁸⁴ The report stressed that any future reductions in water flow would magnify mistrust between Pakistan and India, potentially imperilling the IWT.

With India's population expected to reach 1.5 billion by 2035, the demand for water is rising, but management of the resource remains "extremely decentralised and virtually unregulated".⁸⁵ In Pakistan, economists and water experts warn that increasing scarcity, stemming in part from "the inherent limitations of water supply in the Indus [R]iver system" and partly from "the growing water demand associated with inefficient water use in the process of economic and population growth", is assuming grave proportions. They believe that water disputes with India could provoke a crisis and even, in the extreme, military conflict.⁸⁶

Indian observers believe that water disputes are rapidly becoming the "core issue" in the "Pakistani establishment's

narrative about bilateral problems".⁸⁷ Some Pakistanis concur, with a political analyst emphasising that water issues are already becoming "another Kashmir-like rallying point for Pakistani jihadis".⁸⁸ There is sufficient evidence for such concern. For instance, LeT/JD has held major rallies countrywide, accusing India of a "water war" against Pakistan and calling upon Islamabad to take "practical steps" to counter its "deep conspiracy of making Pakistan's agricultural lands barren and economically annihilating us".⁸⁹ In India, too, according to a senior cabinet member, opponents of peace with Pakistan could use water disputes to disrupt bilateral ties. These spoilers would even want the IWT scrapped altogether, since they contend that 80 per cent of the Indus system has been "given away" to Pakistan.⁹⁰

Improved economic ties and the resultant easing of tensions would provide a more conducive environment to work toward resolving water disputes. The IWT's Article VII calls on the signatories to "recognise that they have a common interest in the optimum development of the rivers, and to that extent, they declare their intention to cooperate, by mutual agreement, to the fullest extent".⁹¹ With water emerging as an increasingly emotive issue, Islamabad and New Delhi should build on the momentum of the ongoing dialogue to hold comprehensive talks that go beyond project-related disputes. Along with using the existing IWT mechanisms for dispute resolution, they should abide by their commitments under the treaty to identify "short, medium and long-term steps for the optimum development of the rivers".⁹² Further cooperation should include joint watershed management, increasing the efficiency of irrigation and water use, joint development of technologies, sustainable agricultural practices and institutional arrangements to manage food shortages and counter natural disasters.⁹³

As their energy needs rise, both countries should also identify opportunities to cooperate in developing hydropower. There are other options for energy sharing, some of which are already being explored. These include a power line, on a joint ownership basis, that would transfer 500 megawatts of electricity from Amritsar to Lahore.⁹⁴ In the

⁸¹ "Baglihar cleared, India has its way", *The Times of India*, 13 February 2007.

⁸² Zeeshan Javaid, "Pakistan might lose more water to India", *Daily Times*, 26 January 2012.

⁸³ Existing resources of surface and groundwater supplies can no longer meet Pakistan's existing irrigation needs. "Avoiding Water Wars", op. cit., p. 6.

⁸⁴ "Avoiding Water Wars", op. cit.

⁸⁵ Water management in India is constitutionally devolved from the centre to the states, which have "limited capacity to coordinate [water sharing] among themselves", leading to a rapid diminution of available surface and groundwater, *ibid*.

⁸⁶ See, for instance, Dr Akmal Hussain, "Pakistan's water crisis", *The Express Tribune*, 15 August 2011.

⁸⁷ Siddharth Varadarajan, "Water as the carrier of concord with Pakistan", *The Hindu*, 25 February 2010.

⁸⁸ Crisis Group interview, Lahore, 21 February 2012.

⁸⁹ James Lamont, "Pakistan steps up water dispute", *Financial Times*, 29 March 2010. See also Rabia Mehmood, "India can never be favourite for Pakistan: Jamaat-ud-Dawa", *The Express Tribune*, 24 November 2011.

⁹⁰ Crisis Group interview, New Delhi, 27 November 2011.

⁹¹ Text of Indus Waters Treaty (1960) at www.worldbank.org.

⁹² Varadarajan, op. cit.

⁹³ Hussain, op. cit.

⁹⁴ Although India currently has electricity shortages, new power lines are to go online by 2015 and are expected to yield an off-

longer term, enlarging a bilateral and a regional energy grid would work in their mutual interest.

Progress is underway in another energy-related sector – petroleum and other fuels. In March 2012, the government disclosed it intended to allow Indian petroleum imports.⁹⁵ India is a major exporter of petroleum products, which are expensive in Pakistan.⁹⁶ While Pakistan will initially rely on tankers, in the longer term the governments are considering pipelines to bring them from India to Pakistan.

The Turkmenistan-Afghanistan-Pakistan-India (TAPI) pipeline is a far more ambitious, \$7.6 billion project, developed by the Asian Development Bank, to carry natural gas from Turkmenistan to India via Afghanistan and Pakistan. In January 2012, Pakistan and Indian energy ministers discussed in New Delhi joint participation in building the envisioned 1,680km pipeline.⁹⁷ “If that gas starts flowing into South Asia, it will make Sui look small”, said Rajiv Kumar, secretary general of the New Delhi-based Federation for Indian Chambers of Commerce and Industry (FICCI).⁹⁸ Should the project materialise, it would not only link Pakistan and India economically but, by making one’s security the other’s necessity, also potentially yield major peace dividends.

peak surplus that could supply Pakistan. “India, Pakistan flesh out electricity trade plans”, *The Hindu*, 27 October 2011.

⁹⁵ “Pakistan plans allowing petrol import from India”, *Dawn*, 23 March 2012.

⁹⁶ Promit Mukherjee, “India to be Asia’s top exporter of petroleum products”, *Daily News and Analysis*, 27 August 2011.

⁹⁷ Under the Gas Sale Purchase Agreement signed between Turkmenistan and the three other countries, the pipeline would supply 3.2 billion cubic feet of natural gas a day to Pakistan and India. Afghanistan would receive transit fees, the size of which so far are agreed only in principle, from Pakistan and India. Ahmad Ahmadani, “Final round of negotiations on TAPI pipeline on 24 May”, *The Nation*, 22 April 2012; “Pakistan, Afghanistan and India agree on transit fee”, *The Express Tribune*, 18 April 2012; Rakesh Sharma and Santanu Choudhury, “India, Pakistan announce joint energy initiatives”, *The Wall Street Journal*, 25 January 2012.

⁹⁸ Crisis Group interview, New Delhi, 27 November 2011. The Sui is Pakistan’s largest natural gas field.

IV. POTENTIAL SPOILERS

A. THE MILITARY AND THE MULLAHS

Some observers believe that the Pakistani military, abandoning decades of rigidity, now favours increased trade with India partly because of concerns about the economy,⁹⁹ but also because many military-owned businesses, particularly cement and farm products, would benefit from access to the Indian market.¹⁰⁰ It is stressed that the political leadership could not have launched the ongoing dialogue and decided to grant MFN status to India without the blessing of the army, which continues to direct Pakistan’s relations with India.¹⁰¹

This line of reasoning wears thin, given the military high command’s continued opposition to MFN status for India and its continued animosity to New Delhi, more than evident in backing for India-oriented jihadi groups such as the LeT/JD. In February 2010, for instance, the army chief, General Ashfaq Pervez Kayani, stressed that the military’s security posture would remain “India-centric” until the Kashmir issue and water disputes were resolved.¹⁰² According to a senior politician privy to the internal discussions of the high command, some senior military officials have made the economic case for better relations with India, but they are a “tiny minority”.¹⁰³ A senior parliamentarian said, “the military establishment wants to maintain its traditional position and impose hurdles [to peace]”, adding, “they are not ready for a full accommodation. Over the years, they have relaxed a little – but only a little”.¹⁰⁴

The military’s pushback against the dialogue process is already evident. Even as Prime Minister Gilani declared that the military was not a legitimate stakeholder in the MFN issue, the military-dominated foreign ministry held consultations with senior military and intelligence offi-

⁹⁹ Crisis Group interviews, Islamabad, January-February 2012.

¹⁰⁰ Farooq Tirmizi, “Analysis: MFN status to India – ‘in principle’ is a negotiating tactic”, *The Express Tribune*, 7 November 2011.

¹⁰¹ For example, according to former State Bank Governor Ishrat Hussain, “the military appears to be fully supportive of free trade with India”. Crisis Group interview, Karachi, 16 January 2012.

¹⁰² Cyril Almeida, “Kayani spells out threats posed by Indian doctrine”, *Dawn*, 4 February 2010. Testifying before the Senate Select Intelligence Committee in February 2012, U.S. Director of National Intelligence James Clapper said that Pakistan continued to view India as an “existential threat”. “Unclassified Statement for the Record: The Worldwide Threat Assessment of the U.S. Intelligence Community for the Senate Committee on Armed Services”, 16 February 2012.

¹⁰³ Crisis Group interview, Islamabad, March 2012.

¹⁰⁴ Crisis Group interview, Islamabad, March 2012.

cialists to discuss the implications of free trade with India.¹⁰⁵ While Foreign Minister Hina Rabbani Khar insisted that the military was indeed a major stakeholder in India-Pakistan relations and supported the MFN decision,¹⁰⁶ the high command reportedly expressed reservations about free trade to “the highest levels of the government”.¹⁰⁷ Facing military pressure, the government claimed the cabinet had decided to grant MFN status merely “in principle” and that the status would only be extended if “the situation is quite favourable and in the national interest”.¹⁰⁸ Soon after, however, the government defied military pressure and insisted it would not reverse the cabinet decision, thereby gaining the confidence of counterparts in New Delhi.¹⁰⁹

Most dangerously, the military refuses to end support to India-oriented militant groups, particularly the LeT/JD and Jaish-e-Mohammad, that could scuttle the normalisation process through another major terrorist attack in India. Such entities are also trying to mobilise opposition to the normalisation process on the streets.¹¹⁰ Buoyed by the release from preventive detention and the court’s decision to drop all cases against Hafiz Saeed,¹¹¹ the LeT/JD resumed its recruitment drives in Pakistan-administered Azad Jammu and Kashmir (AJK) in 2009, alongside Jaish-e-Mohammad and Hizbul Mujahidin. The residents of AJK, concerned about renewed skirmishes between Indian and Pakistani troops and an end to the easing of controls on the LOC, have not welcomed this re-emergence of jihadi militants. This was evident in two large demonstrations in September 2011 in Athmuqam town, close to AJK’s capital, Muzaffarabad. Residents of Athmuqam had earlier passed a resolution declaring that any attempt by the mili-

itants to disrupt peace in the area would be resisted by the people themselves.¹¹²

Alongside their jihadi allies, radical Islamic parties are also attempting to block progress in the liberalisation of Pakistan’s trade with India. With its militant wing, Hizbul Mujahidin, that seeks to wage violent jihad for J&K’s integration into Pakistan, the Jamaat-i-Islami (JI) is at the forefront of the struggle against peace. According to a JI leader and former senator, Khurshid Ahmed, “it is not sound policy to try to achieve economic progress at the expense of political disputes, since politics and economics are intertwined”. He maintained that CBMs, although “useful”, could never be “an effective substitute for the long-term resolution of Kashmir”.¹¹³

The JI is a constituent member of the Pakistan Defence Council (PDC, Difa-e-Pakistan Council), an umbrella organisation of more than 40 jihadi groups, radical Islamic parties aligned with the military, and associates such as Imran Khan’s Pakistan Tehreek-i-Insaf.¹¹⁴ Formed in December 2011, it includes banned terrorist outfits such as the LeT/JD and Sipah-e-Sahaba. The PDC is co-chaired by LeT/JD head Hafiz Saeed and Maulana Samiul Haq, leader of the Jamiat Ulema-e-Islam (JUI-S) faction, commonly nicknamed the “Father of the Taliban”.¹¹⁵ It is widely believed that the military, much like its support for earlier Islamist alliances, backs the council. A Lahore-based political analyst described the PDC as “the latest potion concocted by the generals to keep the jihadi cauldron boiling and impede moves towards peace between Pakistan and India”.¹¹⁶

Holding a number of large public rallies countrywide, including in Rawalpindi, the homebase of the army’s General Headquarters, the PDC has strongly opposed “the terrorism committed by U.S. and NATO forces in Pakistan, drone attacks and the bestowing of MFN status to India”.¹¹⁷ Whether these groups can derail the dialogue process with

¹⁰⁵ Abdul Manan and Kamran Yousaf, “MFN status to India: Army not part of India trade equation”, *The Express Tribune*, 5 November 2011.

¹⁰⁶ Mubashir Hassan, “Military on board over MFN status”, *The Nation*, 6 November 2011.

¹⁰⁷ “Pak Army conveys reservations about MFN status to India”, *The News*, 22 November 2011.

¹⁰⁸ Baqir Sajjad Syed, “Foreign Office clears confusion: MFN status decision to come later”, *Dawn*, 4 November 2011.

¹⁰⁹ Crisis Group interview, Indian commerce ministry official, New Delhi, November 2011.

¹¹⁰ At one such rally, LeT/JD leader Maulana Abdur Rehman Makki warned: “If this decision [to award MFN status to India] is not reversed, then those who are responsible for this decision would be reversed”. Rabia Mehmood, “India can never be a favourite for Pakistan: Jamaat-ud-Dawa”, *The Express Tribune*, 24 November 2011.

¹¹¹ On 2 April 2012, the U.S. announced a \$10 million reward for information leading to Saeed’s arrest. Two days later, addressing press at a hotel in Rawalpindi, around the corner from the army’s General Headquarters, Saeed said, “here I am in front of everybody, not hiding in a cave”. “With \$10 million bounty on his head, Saeed taunts U.S.”, Reuters, 5 April 2012.

¹¹² M. Ilyas Khan, “Anti-militant protests in Pakistan’s Neelum Valley”, BBC News, 15 September 2011.

¹¹³ Crisis Group interview, Islamabad, 27 January 2012.

¹¹⁴ For a full list of constituent members and associates, see the PDC’s official website at: www.difaepakistan.com.

¹¹⁵ The nickname stems from his leadership of the Darul Uloom Haqqania madrasa in Akora Khattak, from which many of the top Taliban leaders, including Mullah Omar, graduated. See Crisis Group Report, *Islamic Parties in Pakistan*, op. cit., pp. 13-14.

¹¹⁶ Crisis Group interview, Lahore, 22 February 2012. According to an informed observer, the PDC “was unleashed by the country’s security establishment because of fraught relations with the U.S. after the 26 November 2011 NATO attack on a Pakistani military border post”. Amir Mir, “A ten million dollar question: Does the U.S. decision to place head money on Hafiz Saeed put him in the dock?”, *The News*, 8 April 2012.

¹¹⁷ Naqib Hamid, “Defending the ‘land of the pure’”, *Daily Times*, 31 January 2012.

India, as the LeT/JD did through the Mumbai attacks, will not depend on popular support but on their ability to leverage military support and their willingness to use violence.

B. THE AFGHANISTAN FACTOR

Indian officials are justifiably concerned about the security implications of the Pakistan military's support to the Afghan Taliban and allied groups such as the Haqqani network, particularly after the drawdown of coalition forces in 2014.¹¹⁸ Afghan insurgents, most notably the Haqqani network, are increasingly allied to India-oriented jihadi organisations such as the LeT/JD and Jaish-e-Mohammad. Relocating many of its operations to Pakistan's tribal belt, bordering on Afghanistan, where it works alongside the Taliban and the Haqqani network, the LeT/JD is now active in six to eight Afghan provinces. It was, for instance, involved in the Haqqani network's attacks on the Indian embassy in Kabul in July 2008 and October 2009, which some analysts believe had the Pakistani military's sanction.¹¹⁹ In 2010, the LeT/JD also planned and helped the Haqqani network execute three major attacks against Indian government employees and private workers in Afghanistan, prompting suspicions that the group has become "one of Pakistan's proxies to counteract India's influence in the country".¹²⁰

On the other hand, Pakistan's military, foreign office and other official institutions say they are deeply wary of India's increased presence in Afghanistan since the ouster of the Pakistan-backed Taliban regime in 2001. They allege that Indian consulates in southern provinces that border Pakistan, such as Nangarhar and Kandahar, are being used to stoke the secessionist insurgency in Pakistan's province of Balochistan and to support Pakistani Taliban groups in the Federally Administered Tribal Areas (FATA).¹²¹ Evoking fears that expansion of Indian influence in Afghanistan would threaten Pakistan's security, apologists for the military are attempting to justify Pakistani support for the Afghan insurgency. The signing of a strate-

gic partnership between India and Afghanistan in November 2011, which includes training and light weapons for the Afghan army and support for the Afghan air force, is cited by hardliners as evidence of Indian expansionist ambitions.¹²²

According to a senior retired military official, Pakistan had "every right to be wary of India's increased penetration of Afghanistan"; he cautioned: "Indian attempts to erode Pakistan's legitimate interests in Afghanistan could slow down the momentum of the overall India-Pakistan normalisation process".¹²³ Another retired general emphasised: "Relations between the U.S. and Pakistan are already strained as it is, and the Indian factor in Afghanistan will make Pakistan even more reluctant to accede to American demands regarding the Taliban and the Haqqani network"; and added: "As long as Pakistan suspects India of propping up and sustaining its proxies in Kabul, it would continue to support Afghan groups opposed to India, chief among them being the Taliban".¹²⁴

Indian analysts insist that Pakistani fears of a pro-India Afghan army are exaggerated. As the former foreign secretary, Shyam Saran, argued: "No sensible policymaker would support going down the bottomless pit of the ANSF (Afghan National Security Forces), after more than ten years of heavy investment by the U.S. and others has failed", a position reaffirmed by others in New Delhi.¹²⁵ But Saran also emphasised: "India will not accept that it has no role in Afghanistan, with more than \$2 billion already invested"; and added: "As long as there is a presumption that Delhi's and Islamabad's interests are fundamentally divergent, India will do what it can to safeguard its interests".¹²⁶

India would certainly want to prevent the re-emergence of the Taliban as the dominant force in Afghanistan following the withdrawal of U.S. and NATO forces, which would give new sanctuaries to Pakistani jihadi groups such as the LeT/JD and the Jaish-e-Mohammad. While India's and Pakistan's rivalry in Afghanistan will likely intensify as the NATO drawdown is completed, a far more immediate threat to the ongoing normalisation process lies in the Pakistan military's continued backing for anti-Indian jihadis as well as a disruption of the country's fragile democratic transition.

¹¹⁸ For more detail, see Crisis Group Report, *Talking About Talks*, op. cit.; and Asia Briefing N°115, *Afghanistan: Exit vs Engagement*, 28 November 2010.

¹¹⁹ Mark Mazetti, Eric Schmidt, "Pakistanis aided attack in Kabul: U.S. officials say", *The New York Times*, 1 August 2008.

¹²⁰ Alissa J. Rubin, "Militant group expands attacks in Afghanistan", *The New York Times*, 15 June 2010.

¹²¹ For more on the insurgency in Balochistan, see Crisis Group Asia Briefing N°69, *Pakistan: The Forgotten Conflict in Balochistan*, 22 October 2007, and Crisis Group Asia Report N°119, *Pakistan: The Worsening Conflict in Balochistan*, 14 September 2006. For details about the insurgency in FATA, see Crisis Group Asia Reports N°178, *Pakistan: Countering Militancy in FATA*, 21 October 2009; and N°125, *Pakistan's Tribal Areas: Appeasing the Militants*, 11 December 2006.

¹²² Crisis Group interviews, Rawalpindi, Islamabad, December 2011.

¹²³ Crisis Group interview, Rawalpindi, 1 December 2011.

¹²⁴ Crisis Group interview, Islamabad, 1 December 2011.

¹²⁵ Crisis Group interview, Shyam Saran, 22 November 2011; Crisis Group interviews, New Delhi, November 2011.

¹²⁶ Crisis Group interview, Shyam Saran, New Delhi, 22 November 2011.

V. THE VIEW FROM NEW DELHI

A. BILATERAL RELATIONS AND REGIONAL PEACE

Indian policymakers are concerned that the Pakistani military could still overturn a fragile democratic transition if provoked – including should the PPP government's dialogue with India progress without the high command's sanction. As alleged in U.S. diplomatic cables made public by WikiLeaks, the Pakistani military has indeed come close to upsetting the political order numerous times since February 2008, when the civilian government was sworn in.¹²⁷

According to some Indian policymakers, Pakistan's transition to civilian rule has obscured New Delhi's understanding of civil-military relations and whether and to what extent the centre of power has shifted in Islamabad. "We keep seeing examples of the military's veto power, for example when [ISI chief] Pasha was supposed to visit India after the Mumbai attacks, but the military reversed the decision", said Shyam Saran. "A visit that could have helped us move past the incident was instead blocked".¹²⁸

Within India, Prime Minister Singh faces multiple challenges limiting his room to manoeuvre. Beset with corruption scandals, his United Progressive Alliance (UPA) government has lost public support and confidence, and the Congress Party will likely face an uphill task in regaining that support in the next general elections.¹²⁹ More specifically, Singh also faces considerable resistance – from the Bharatiya Janata Party (BJP)-led opposition, powerful bureaucracies, particularly the home and defence ministries, and even, albeit to a lesser extent, within his own party – to any dialogue with Pakistan that does not prioritise the terrorist threat. "So far, the voice moving this forward is coming from the prime minister's office and a senior level of the foreign office", said Dr Suba Chandran, director of the New Delhi-based Institute of Peace and Conflict Studies (IPCS). Describing the home and defence ministries as too "inward-looking", he said, "some key ministries are resistant. The home ministry, for example, is extremely

conservative, so the question is: how much influence will it exert on and with respect to the prime minister?"¹³⁰

Singh has thus far successfully countered bureaucratic and political resistance to the normalisation process. As the composite dialogue continues, his challenge, and that of the Congress Party should it emerge in the general elections as the largest component in what is likely to be another coalition government, will be to gain more domestic support. There is certainly sufficient ground for optimism, however, that the process could continue uninterrupted even if the prime minister, who has personally driven it, is replaced after the elections.

According to informed observers, the normalisation process has faced far less resistance from the Congress Party than Singh's predecessor, Atal Behari Vajpayee, encountered from the BJP when the composite dialogue began in 2004.¹³¹ Yet, Vajpayee's government chose to sideline opponents and opted for rapprochement with Pakistan. Should the BJP win the next election and form the government, it is unlikely to derail the process. In fact, some Indian analysts believe that the party now appears "on the same page as the government in relation to a peace process with Pakistan".¹³² The current direction of policy toward Pakistan will likely remain unchanged if the BJP wins the next election – unless, as discussed below, another terror attack brings an abrupt halt.

Even those within the bureaucracy most concerned about the direction of engagement with Pakistan, including in the external affairs ministry, believe that abandoning talks altogether is a "non-option".¹³³ Many Indian policymakers, as well as economists and the business community, consider that an expansion of economic ties with Pakistan would yield peace dividends. Enhanced trade, potentially followed by direct investment, would not only consolidate commercial linkages but also raise each country's stake in the security of the other.¹³⁴ If terrorist threats from and insecurity in Pakistan have provoked rigidity in some Indian stakeholders, they have engendered a sense of urgency in others, particularly the business community, which strongly backs the normalisation process. "The Indian business community is supporting this not just for material interest, but also for the normalisation process", said Rajiv Kumar, of the Federation of Indian Chambers of Commerce and Industry (FICCI). "An imploding Pakistan is not

¹²⁷ For instance, in a U.S. embassy Islamabad cable released by WikiLeaks, General Kayani is reported to have told Ambassador to Pakistan Anne Patterson in March 2009 that he "might reluctantly have to persuade Zardari to resign" and could support Awami National Party leader Afsandiyar Khattak as his replacement. Cited in "Kayani doesn't want Nawaz ruling: WikiLeaks reports reveal Kayani mulled ousting Zardari, backing Afsanyar for new president during March 2009 crisis", *Daily Times*, 2 December 2010.

¹²⁸ Crisis Group interview, New Delhi, 22 November 2012.

¹²⁹ Indian general elections are currently scheduled for 2014.

¹³⁰ Crisis Group interview, New Delhi, 24 November 2012.

¹³¹ Crisis Group interview, New Delhi, 21 November 2011.

¹³² Radha Kumar, "Renewing the India-Pakistan peace process", *Daily Times*, 19 April 2012. Dr Kumar is director, Peace and Conflict Program, Delhi Policy Group.

¹³³ Crisis Group interview, external affairs ministry official, New Delhi, November 2011.

¹³⁴ Crisis Group interviews, New Delhi, November 2011.

good for Indian business; it's the number one scare, so they are prepared to give up a little space [to Pakistani goods]".¹³⁵

Peace and trade with Pakistan are, moreover, considered a political necessity for India's broader foreign policy goals. A stable and peaceful neighbourhood is essential for its aspirations to play not just a regional but also a global role, commensurate with its size and potential. Indian policy-makers and the business community have also long recognised the benefits of a more integrated South Asian economic and political zone. India is currently opening its markets to South, South East and Central Asia. For instance, in August 2009, India and ASEAN signed a trade-in-goods agreement, producing one of the world's largest free trade areas. In the second half of 2011, as political change in Dhaka provided fresh opportunities for cooperation, New Delhi also signed trade agreements with Bangladesh.

While India's potential as an emerging power depends in large part on better and deeper relations with its neighbours, its size has provoked apprehensions of economic and political domination in much smaller countries, including Pakistan. To overcome such concerns, a former Indian foreign secretary said:

The only option is if the economic dynamism that India has demonstrated can provide an impetus for economic growth for our neighbours. The economy is so large, and it is growing so rapidly, that we can open our market to our neighbours without a downside. Even if we took every good produced by the neighbouring countries, it would be a drop in the ocean for the Indian economy, except for textiles and tea.¹³⁶

India's Punjab-based businesses are especially keen to expand trade with Pakistan, viewing it as an opportunity to tap a market with similar consumer patterns and tastes, as well as a way to open the borders of their landlocked state.¹³⁷ Similarly, influential lobbies in Gujarat and even Maharashtra, whose capital is Mumbai, have provided critical support to the trade talks.¹³⁸ These include automobile

manufacturers, pharmaceutical companies, the hospitality industry, the entertainment business and the information technology sector.¹³⁹ Indian businesses also seek resources beyond Pakistan, such as hydrocarbons and minerals from Central Asia, that could be far more easily acquired and at lower cost through Pakistan. Unsurprisingly, as in Pakistan, the lobbies that oppose free trade justify it on the grounds of perceived threats to local business and industry, but these are ultimately unlikely to derail liberalisation efforts. For example, New Delhi overcame considerable opposition from some sectors to the free trade agreement with ASEAN.

Softening of the border with Pakistan, however, will be far more challenging. The home ministry in particular has resisted relaxing travel and visa restrictions with Pakistan and other neighbours, citing security concerns. Yet many serving and retired senior Indian officials believe the security fixation, while understandable, is severely limiting. "Many lobbies are telling the government that this is now counter-productive", said Shyam Saran. "On the one hand, we're talking about free flow of goods, trade, and open borders, but then this is not matched by action".¹⁴⁰ "We need to get over David Headley Cole", said a senior official, referring to the Chicago-based Pakistani-American who admitted to conspiring with the LeT and Pakistani military officials in the Mumbai plot, adding: "Security procedures should be balanced by regional and foreign policy interests".¹⁴¹ A National Intelligence Grid, approved by the Cabinet Committee on National Security in June 2011, might meet some of these concerns, by giving the home ministry access to twenty databases, including travel records and immigration details.¹⁴²

B. TERRORISM AND THE NORMALISATION PROCESS

On 8 April 2012, during President Asif Ali Zardari's visit to India, the first by a Pakistani head of state in seven years, Prime Minister Singh accepted an invitation to visit Pakistan, and both leaders expressed their commitment to the normalisation process. "Relations between India and Pakistan should become normal. That's our common concern", said Singh. The prime minister, however, also stressed that it "was imperative to bring the perpetrators

¹³⁵ Crisis Group interview, New Delhi, 27 November 2011.

¹³⁶ Crisis Group interview, Shyam Saran, New Delhi, 21 November 2011.

¹³⁷ Currently Punjabi traders move goods mainly through the coastal state of Gujarat.

¹³⁸ An Indian analyst noted that Akali Dal leader and Punjab Chief Minister Parkash Singh Badal, speaking at the opening of the new check post at the Wagah-Attari border, said: "I am desperately waiting for the day when people of both the Punjabs would freely move across the borders without visa restrictions". Raja Mohan added that Badal's stance was also a cue to Gujarat Chief Minister Narendra Modi, since "most of the expanding trade flows between India and Pakistan will run through the ports of Gujarat as facilities for overland trade take time to develop".

C. Raja Mohan, "After Attari", *Daily Times*, 17 April 2012. Dr Mohan is senior fellow, Centre for Policy Research, New Delhi.

¹³⁹ Crisis Group interviews, business and industry representatives, New Delhi, November 2011.

¹⁴⁰ Crisis Group interview, New Delhi, 21 November 2011.

¹⁴¹ Crisis Group interview, New Delhi, November 2011.

¹⁴² Gurmeet Kanwal, "Fighting terrorism: Policies mired in systematic weaknesses", *The Tribune*, 20 February 2012. Kanwal is director, Centre for Land Warfare Studies, New Delhi.

of the Mumbai attacks to justice and prevent activities against India from Pakistani soil".¹⁴³

From New Delhi's perspective, the terrorist threat is the most significant impediment to the normalisation process. Indian officials and analysts are concerned that Pakistan-based jihadi groups, opposing the government's normalisation process and currently attempting to mobilise anti-India sentiments on the streets, could launch another major attack in India.¹⁴⁴ Such an incident would disrupt the dialogue process and could even result in New Delhi opting this time to abandon restraint for a military response that could potentially escalate into all-out war between the nuclear-armed neighbours.

IPCS's Suba Chandran queried:

Are we moving in a linear path or in a circle? Are we in the same place we were three, or seven or ten years ago? The fear is that in the next two to three years, the visa regime will relax, there will be exchanges of professionals, there will be cricket matches, and so on, but then one [terror] incident will set everything back and reverse all progress.¹⁴⁵

A senior cabinet minister said:

We can't be completely optimistic [about the current talks] If the normalisation process doesn't bear fruit, the forces against it would acquire greater credibility. The written word [such as agreements reached thus far] is not enough. More trade is all well and good, but you will not resolve disagreements over transit and water unless you resolve the main issue, which is distrust because of the terrorism factor.¹⁴⁶

Pakistan's response to the Mumbai attacks has done little to restore New Delhi's confidence, despite the ongoing trial in a Pakistani anti-terrorism court – the first ever for terrorist acts committed on foreign soil – of seven people allegedly involved in those attacks. With a conviction rate of less than 5 per cent in major criminal and terrorism cases, due to poor policing and inadequate investigative and prosecutorial resources,¹⁴⁷ the defendants could pos-

sibly be acquitted. Yet, India's main grievance is not the failure of Pakistan's justice system but a perceived lack of sincerity by Pakistani state institutions.

"It took us eleven, twelve years to solve and obtain a conviction for the Rajiv Gandhi assassination [by an LTTE suicide bomber], despite strong evidence and a skilled investigation team", said an Indian political analyst. "But there was never a question about Sri Lanka's sincerity. The Sri Lankan president said, 'we will go all the way to help the investigation'. So, even if the courts said there was no adequate proof, we would still have accepted the process. The problem is that we do not see that level of sincerity and cooperation from Pakistan".¹⁴⁸

With attacks against the Pakistani state and citizens escalating since 2008, the Singh government has tried to portray terrorism as a joint challenge rather than solely as a threat to Indian security. However, according to former Foreign Secretary Kanwal Sibal, "this idea of a moral equivalence between the terrorist threat in Pakistan and in India is where the prime minister has lost ground politically. The prime minister is saying that another attack would be a big setback, but he is not saying that it would end the dialogue. This is risky, particularly since we have seen no movement from Pakistan on Mumbai".¹⁴⁹ The lack of knowledge in India about Pakistan's reasons for inaction against India-oriented jihadi groups – whether this is because of bad faith, domestic political constraints resulting from public support for those groups or the military's agenda – creates uncertainty about the prospects for enduring peace. "How deep is Pakistan's self-introspection?", asked Sibal. "Will it really lead to a change of direction?"¹⁵⁰

The resulting mistrust has hampered even the limited cooperation between Pakistan and India on counter-terrorism. For example, in March 2012 Pakistani lawyers, prosecutors and investigators visited India to obtain evidence for the Mumbai case but were denied access to Ajmal Kasab, the sole surviving gunman in the attacks, convicted of murder, conspiracy, and waging war against India in May 2010.¹⁵¹ According to former Foreign Secretary Saran, "bilateral law enforcement cooperation is working with Nepal and Bangladesh, but that is because of a change

¹⁴³ "I have taken advantage of this visit", said Singh, "to discuss with him all bilateral issues and I am very satisfied with the outcome of this visit". "Text of statement of Prime Minister Dr Manmohan Singh and President of Pakistan in New Delhi", external affairs ministry, 8 April 2012.

¹⁴⁴ Crisis Group interviews, Indian officials, New Delhi, November 2011.

¹⁴⁵ Crisis Group interview, New Delhi, 24 November 2011.

¹⁴⁶ Crisis Group interview, New Delhi, 27 November 2011.

¹⁴⁷ For extensive analysis on the weaknesses of investigations, prosecutions and the criminal justice system in general, see Crisis Group Report, *Reforming Pakistan's Criminal Justice System*,

op. cit. See also Asia Reports N°160, *Reforming the Judiciary in Pakistan*, 16 October 2008 and N°157, *Reforming Pakistan's Police*, 14 July 2008.

¹⁴⁸ Crisis Group interview, Suba Chandran, New Delhi, 24 November 2011.

¹⁴⁹ Crisis Group interview, New Delhi, 23 November 2011.

¹⁵⁰ Ibid.

¹⁵¹ According to an Indian analyst, access was denied because Kasab's appeals were being heard, and "the only way that access to him could be given would be if the prosecutions in India and Pakistan are clubbed". Radha Kumar, "Renewing the India-Pakistan peace process", *Daily Times*, 19 April 2012.

in political attitudes in those countries. If there was a sense in India that while prosecution rates are low in Pakistan, there was a clear signal that the state was ready to turn its back on jihadi groups, the situation would be different".¹⁵²

THE KASHMIR IMPASSE

While Pakistan's relations with India should certainly evolve and to some extent are already going beyond a narrow Kashmir-centric approach, stronger economic links would not only strengthen existing and create new constituencies for peace in both countries but also open opportunities for a meaningful dialogue on longstanding disputes, including Kashmir. A Pakistani parliamentarian rightly noted: "So far, in 65 years, we've pursued one policy: armed conflict. It has failed. Now we have to try the soft approach – softer borders, fewer visa restrictions, deeper commercial ties", emphasising, "when the economic stakes rise on both sides, even a solution on Kashmir would be much easier".¹⁵³

Since the composite dialogue began in 2004, Pakistan and India have generally observed a ceasefire across the LOC, even during periods of heightened tension, such as in the aftermath of the Mumbai attacks, but limited skirmishes and militant infiltration still occur. Both AJK and J&K also remain heavily militarised, and the manner in which Islamabad and New Delhi administer them is largely responsible for Kashmiri alienation. Popular disaffection in J&K still has the potential to turn violent due to the long record of human rights abuses by Indian security agencies and frequent crackdowns on separatist leaders and supporters. In AJK, Kashmiris are denied political freedoms, all kinds of dissent are silenced, including via a ban on political parties that do not support J&K's accession to Pakistan. Hence there is a pressing need for both countries to urgently enact vital and long overdue reforms in the parts of the territory they control.

Violence in Indian-administered J&K is at the lowest levels since the separatist uprising began in 1989, but alienation runs deep.¹⁵⁴ Though violent clashes between demonstrators and security personnel occur periodically, security agencies have been relatively more restrained than in the recent past.¹⁵⁵ In 2010, for instance, they killed three people they claimed were Pakistan-based militants but were later found to be locals killed for cash rewards in a staged

¹⁵³ Crisis Group interview, PML-N National Assembly member Khawaja Mohammad Asif, Islamabad, 21 March 2012.

¹⁵⁴ For more detail and analysis of J&K's political structures and governance, see Crisis Group Briefing, *Steps Towards Peace*, and Report, *Kashmir: The View From Srinagar*, both op. cit.

¹⁵⁵ Protest marches by Kashmiri separatists and shutdowns still occur frequently in J&K. For instance, in November 2011, protesting youths and the police clashed after Eid-ul-Azha celebrations; in February 2011, protests led by Jammu and Kashmir Liberation Front (JKLF) Chairman Yasin Malik and others also resulted in clashes with the police.

¹⁵² Crisis Group interview, New Delhi, 21 November 2011.

encounter.¹⁵⁶ During resultant protests, a tear gas shell killed a seventeen-year-old student.¹⁵⁷ In subsequent demonstrations led by the All Parties Hurriyat Conference (APHC)¹⁵⁸ against the Indian military presence and human rights violations, protestors defied curfews, attacked security forces with stones and set government buildings on fire.¹⁵⁹ Indian police and paramilitaries responded with live ammunition, killing at least 110. The violence subsided when New Delhi announced measures to defuse tensions, including release of detained students; reopening of schools and universities; and compensation to families of those killed in the clashes.¹⁶⁰

New Delhi also set up a team of interlocutors to “suggest a way forward that truly reflects the aspirations of the people of Jammu and Kashmir”. Proposing greater autonomy for J&K, the report, “A New Compact with the People of Jammu and Kashmir”, recommended limiting the central parliament’s authority to make new laws applicable to J&K to those that touched vital national and external security and economic interests. Other recommendations included human rights and rule-of-law reform and review of the Armed Forces Special Powers Act (AFSPA). The report was submitted in October 2011, but, according to a major Indian daily, the cabinet “has yet to find time to discuss, let alone open up to a serious political debate”.¹⁶¹

Despite the decline of violence in 2011, which coincided with improved relations between India and Pakistan, J&K remains heavily militarised, and draconian laws that provide legal cover for human rights abuses by security officials remain in force. The most controversial, the Armed Forces Special Powers Act, gives the army widespread powers to search houses, arrest people without warrants and detain suspects indefinitely. During the last two decades, thousands of Kashmiris have disappeared as a result of security operations. An investigation conducted by the J&K State Human Rights Commission in 2011 found 2,156 bodies in unmarked graves at 38 sites in northern Kashmir.¹⁶² While the Indian government claimed that the bodies were all of unidentified, mostly Pakistani, militants

that had had been given to village authorities for burial, at least 574 were identified as local Kashmiris.¹⁶³

Despite overwhelming evidence from independent local and international rights organisations that the Armed Forces Special Powers Act is responsible for facilitating the perpetration of major human rights violations, the Singh government has yet to fulfil its electoral pledge to repeal it. The defence establishment has opposed even minor amendments suggested by the home ministry¹⁶⁴ and has rebuffed J&K Chief Minister Omar Abdullah’s proposal to withdraw the law from two districts where the Indian army does not conduct operations.¹⁶⁵

Draconian laws and repressive actions not only contravene constitutional rights and further erode Kashmir’s special constitutional status,¹⁶⁶ but also embolden hardliners and extremists on both sides of the LOC. Brutal suppression of dissent in J&K lends credence to the separatist argument of fighting a tyrannical occupying force. It also undercuts the ability of civilian governments in Islamabad to expand domestic constituencies for peace, instead further empowering the military and its jihadi proxies, who then dictate the Kashmir agenda. As an immediate first step, New Delhi should follow through on pledges to repeal the AFSPA and other laws that encourage human rights violations and replace a military-led counter-insurgency approach with accountable policing.

In Pakistan-administered Kashmir, Islamabad gives the local government only the trappings of sovereignty, without any meaningful authority. The AJK Council, headed by Pakistan’s prime minister, formally has the power to override laws passed by AJK’s elected legislature, and the

¹⁵⁶ Muzamil Jaleel, “Fake encounter at LOC: three arrested, probe ordered”, *The Indian Express*, 29 May 2010.

¹⁵⁷ Lydia Polgreen, “A youth’s death in Kashmir renews a familiar pattern of crisis”, *The New York Times*, 11 July 2010.

¹⁵⁸ Formed in 1993, the APHC is a coalition of political parties and groups opposed to Indian rule in Kashmir.

¹⁵⁹ Jim Yardley and Hari Kumar, “Buildings are set ablaze during protests in Kashmir”, *The New York Times*, 11 September 2010.

¹⁶⁰ Ashiq Hussain, “Valley victims accept compensation, quietly”, *Hindustan Times*, 20 February 2011.

¹⁶¹ “New Compact faces old problems”, *The Hindu*, 16 April 2012.

¹⁶² “J&K Human Rights Commission’s Special Investigation Team confirms 2156 unidentified bodies in ‘mass graves’”, *The Hindu*, 22 August 2011.

¹⁶³ “India”, Country Summary, Human Rights Watch World Report 2012.

¹⁶⁴ “India: Repeal Armed Forces Special Powers Act”, Human Rights Watch, 19 October 2011.

¹⁶⁵ “Omar Abdullah seeks PM’s support on AFSPA”, *Hindustan Times*, 14 November 2011; Simon Denyer, “Violence wanes in Kashmir but India maintains tight military grip”, *The Washington Post*, 6 December 2011.

¹⁶⁶ India constitutionally enshrined J&K’s accession in Article 370 of the 1950 constitution. In accordance with the Instrument of Accession signed by Kashmir’s ruler Hari Singh, the powers of the Indian parliament in J&K were limited to defence, external affairs and communications. All other powers were vested in the state’s Constituent Assembly. By the 24 July 1952 Delhi Agreement between Prime Minister Nehru and J&K’s then-Prime Minister Sheikh Abdullah, the Constituent Assembly retained its special powers. Although J&K lost much of its autonomy under the 1965 Kashmir accord between Abdullah and Prime Minister Indira Gandhi, it retained its special status under Article 370. Crisis Group report, *Kashmir: The View From Srinagar*, op. cit., pp. 6-7.

AJK judiciary cannot review its decisions.¹⁶⁷ However, though the Council is ostensibly all-powerful, it has very little authority in practice, because the military exercises almost complete control over the territory. This lack of autonomy and the absence of political freedoms are major causes of Kashmiri alienation. Policymakers in Islamabad and Muzaffarabad should prioritise reforms that end AJK's over-dependence on the centre, stimulate the local economy, end the military's pervasive presence and open the political debate to all shades of Kashmiri opinion.

While Pakistan's civilian leadership has managed, with some success, to improve bilateral relations and increase bilateral trade with India, Islamabad should also include AJK's civilian institutions, particularly elected bodies, in the normalisation process. Since Kashmiri buy-in would be vital to full implementation of any agreed-upon Kashmir-specific CBMs, let alone any durable future settlement, both Pakistan and India would stand to gain from meaningfully engaging an alienated Kashmiri public in the political process in general, and more specifically in bilateral talks. It is in Islamabad's and New Delhi's mutual interest to be seen by Kashmiris as sincere partners committed to improving Kashmiri lives, rather than as adversaries seeking a settlement for their own gain.

VI. CONCLUSION

Although there is no immediate and direct correlation between bilateral trade and the Kashmir dispute, deeper economic ties would help repair the breach between Pakistan and India. Potentially a roadmap for a far broader relationship between the two countries lies in the current composite dialogue. The challenge is for Islamabad and New Delhi to build on what has been achieved.

The democratic transition in Pakistan is fragile,¹⁶⁸ with the military still exercising a veto over key policy areas, including Kashmir, India and external security. It is more likely that the high command will impede than support the normalisation process. As a political economist argued, the military "has always resisted such moves in the past, so it is too early to say if they will [not do so] this time".¹⁶⁹

Yet, the civilian leadership has taken some significant steps forward even when confronted by military resistance, particularly on MFN. If the democratic transition continues, and as elected civilian governments find their footing and are more able to dictate foreign policy preferences, there will be new prospects to move beyond a rigid, Kashmir-centric approach to India – regardless of which party forms the government after the next election, since the main contenders, the PPP and PML-N, support broader bilateral ties and regional peace.¹⁷⁰ Given Pakistan's significant economic challenges, enhanced economic ties would also encourage the more comprehensive economic reforms needed at home to produce a better climate for bilateral trade and investment.

Given the risk that another terror attack traced back to Pakistani soil could spark armed conflict, Islamabad must take action against all India-oriented militant organisa-

¹⁶⁷ For more detail and analysis of AJK's political structures and governance, see Crisis Group Briefing, *Steps Towards Peace*, and Report, *Kashmir: The View From Islamabad*, both op. cit.

¹⁶⁸ Confrontation between the ruling PPP and its PML-N opposition reached new heights following Prime Minister Gilani's conviction on contempt-of-court charges by the Supreme Court on 26 April 2012, with Nawaz Sharif insisting that he step down immediately, and the prime minister refusing. An escalation of the crisis could, as in the flawed transition of the 1990s, give the military an opportunity to disrupt the democratic order. Abdul Manan and Qamar Zaman, "No PPP premier will write Swiss Letter: PM; Gilani again challenges PML-N to bring no-confidence motion; opposition leader clarifies statement", *The Express Tribune*, 30 April 2012. For background on the role of the two parties in providing the military a pretext to intervene and dismiss elected governments during the 1990s, see Crisis Group Asia Reports N°203, *Reforming Pakistan's Electoral System*, 30 March 2011; N°137, *Elections, Democracy and Stability in Pakistan*, 31 July 2007; and N°102, *Authoritarianism and Political Party Reform in Pakistan*, 28 September 2005.

¹⁶⁹ Crisis Group interview, Karachi, January 2012.

¹⁷⁰ Pakistani general elections are currently scheduled for 2013.

tions and hold any outfit or individual responsible for such acts of violence to account. India's concerns about military-backed jihadi groups are legitimate, but it should not allow security concerns to define and encumber dialogue with Pakistan's civilian leadership. Just as it took time for India to open up its domestic economy in the 1990s, the pace of economic cooperation with Pakistan will also be slow and its impact not immediately manifest. Nevertheless, the Indian government should be more flexible and patient, given that such obstacles are far greater for Pakistan's elected government and civilian institutions.

A senior Pakistani government official and economist rightly noted: "Once the governments make a breakthrough and remove barriers, it will be the private sector and the individual agent driving trade".¹⁷¹ Such a breakthrough will require not just reduced tariffs and deregulated economies, but also a relaxed visa regime that enables greater movement across the border. To allow this, Pakistan and India will have to overcome the deep mistrust that has impeded cooperation between their governments and hampered interaction and engagement between two peoples that could form the bonds necessary for both economic vitality and a sustainable peace.

Islamabad/Brussels, 3 May 2012

¹⁷¹ Crisis Group interview, Islamabad, 4 April 2012.

