

# **India-Pakistan Strategic Competition: Prospects for a Sustain Economic Cooperation**



**A Thesis Submitted in Partial Fulfillment of the Requirement for the Degree of**

## **MASTER OF PHILOSOPHY in International Relations**

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## Chapter 1

### Introduction

The conflict started after the independence of Pakistan and India in August 1947 is still being carried by the two neighborly countries. This conflict during its course has been punctuated by three full scale wars, one fierce battle at Kargil and persistent cross-border incursions and cross firing. The absence of significant economic and trade relations have been one of the critical factors that have allowed the conflict to persist between the two countries.<sup>1</sup> There have been numerous attempts by both sides in order to normalize the strained relations but they have not been able to normalize the relations to an extent where all outstanding issues could be solved amicably. There has been a little appreciation to trade as a weapon of peace from both sides despite the fact that bilateral trade has a greater propensity to pave the way for the resolution of enmities and intractable conflicts.

The process of globalization starting in 1980s reached almost its peak after the end of Cold War in the last decade of 20<sup>th</sup> century with the sole superpower and its allies announcing the era of liberalization of trade and economics under the principle of interdependence and inter-state cooperation. Under the banner of this principle the long divided and quarrelling East and West Europe started to integrate itself through the expansion of European Union. Similarly, East Asian countries enlisted themselves in the list of developed economies by claiming the status of “Asian Tigers” through the principle of trade and economic interdependence and liberalization. The example of Germany and France also lends credence to the fact that economic and trade

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<sup>1</sup> T.V Paul , “Why has the India-Pakistan Rivalry been so enduring? Power Asymmetry and an Intractable Conflict,” *Security Studies*, Vol.15, No.4,2006, pp. 600-630

liberalization can foster a peaceful relationship despite having a vicious and conflicting history in which numerous wars were fought.

In the Indo-Pak context, despite a conflict-ridden history there are still chances that all the conflicting issues can be resolved peacefully with bilateral trade. It is perhaps the most suitable of all other possible options. It is evident from the encouraging public opinions from both sides of the border. The Lahore Peace initiative being the most recent event in which serious efforts were made to normalize the relations by both countries. People's appreciation of any peace initiative taken demonstrates that people on both sides of the border do not want Indo-Pak relations remained hostage to hatred any longer. However, these peace prone initiatives have proved short-lived in developing a normal relationship because of the lack of flexibility on the part of leaders of both countries.

Bilateral negotiations come to a deadlock when the issue of Jammu and Kashmir is addressed to which both countries associate antagonizing claims. Pakistan refers to the dispute over the status of Jammu and Kashmir as the unfinished agenda of the Partition the core issue of the bilateral conflict. India, on the other hand, considers Jammu and Kashmir its integral part and any harm to its position on it will challenge its very statehood since it has implications for its multi-ethnic, multi-religious stature. Their stances on the issue have hardened to an extent that the Line of Control has become a permanently engaging border where daily exchanges of fire across occurs. Both countries have taken extreme positions on the issue of Jammu and Kashmir in their respective domestic audiences that any compromise of the stance may bring some grave internal challenges to both. Pakistan has brought the issue on top of its domestic agenda while India has adopted a maximalist and a minimalist position on Line of Control in terms of its territorial

position. Despite the huge human and economic costs of the conflict, both countries have not insisting on their respective maximalist positions thus failing to figure out the cost of conflict unacceptable.

The world, however, has greatly changed as a result of globalization in which cooperation has become a better and advantageous policy over the policy of competition which is characterized by zero-sum game. Unlike in competition, in cooperation both partners receive the benefits and advantages. This is a simple concept that the leaders of India and Pakistan have been unable to realize and consequently both the countries lag behind the rest of the world in terms of economic growth. The continuing conflict not only undermines the prospects of peace in the region but also undermines the opportunities for cooperation between the two countries.

Global and regional winds of change have awakened the region of South Asia to open up its economy to cope with the changing dynamics. India and Pakistan, the two most important countries in this region, have failed to reflect the aspiration of the region. Other countries of the region have been influenced by the logic of economic liberalization and high growth rates and have been able to reduce trade barriers. However, due to India and Pakistan's apathy towards this process the success remains remote. There is a common understanding within the South Asian Association for Regional Cooperation (SAARC) that trade within the region should be liberalized. Going by the traditional argument, trade expansion in the region would result in cheaper imports and provides a greater market for regional exports. Such cooperation is backed by a stronger political proposition that it would empower the countries of the region to collectively project themselves on multilateral stage at regional levels, e.g. in establishing links with other regional associations such as ASEAN and APEC, and at global level such as WTO.

There have been serious attempts by the regional countries to overcome the low regional trade in the form of South Asian Free Trade Area (SAFTA), however, lack of amicable relations between India and Pakistan has slowed down this process.

Today there are numerous factors that compel India and Pakistan to shun the path of conflict and seek greater cooperation. Besides good political reasons, there are good economic reasons for improving the bilateral relations. Any aspiration to become a greater power in the region and beyond on the part of India and Pakistan is deemed to remain only an aspiration unless the two countries do not solve their problems. There have been various promising initiatives which could have led to a solution of all outstanding issues between the two countries if the process of normalization had lasted. After having lost those golden chances the two countries have now reached an impasse where suspicion and distrust are prevalent. Pakistan has not been able to give an official status of Most Favoured Nation (MFN) to India and refuses to open up trade with it. On the other hand, India's suspicion of Pakistan regarding Iran-Pakistan-India (IPI) gas pipeline also undermines trade liberalization between the two countries.

There has been much focus on militarization in both India and Pakistan with both the countries engaged in increasing their respective conventional and non-conventional military prowess. A huge percentage of fiscal budgets are allocated in both countries to defence industry including imports of sophisticated military technologies from their respective international partners. It should be realized that this way of militarization is futile, full of grave risks, and economically and humanly very costly. However, the path of cooperation is destined to bring benefits to both with harm to none. It is against this backdrop that the trade liberalization can foster peace process if it is used as a weapon of peace. Trade liberalization between the two countries has the

ability not only to solve all the political and military problems but also has the ability to make the two countries prosperous and powerful.

### **Statement of the Problem**

The peace and stability in South Asia is directly dependent upon the stabilization of relations between India and Pakistan. The cost of the conflict in the region has been too heavy for India and Pakistan where both have huge populations with poverty a serious problem. Both countries in spite of huge socio-economic under-development at home are still spending a hefty amount in their respective defence sectors. The 21<sup>st</sup> century is marked by the economic development and trade liberalization among the states outweighing traditional military competition. The concept of security that was confined to physical and border security is also transformed into the human security which emphasizes the need to pay special attention on the socio-economic aspect of the society while formulating the idea of national security. In the backdrop of the significance of human security and the desire of South Asian people for peace; there exist a window of opportunity for both India and Pakistan to utilize the environment of trade cooperation and transform their relationship from arch rival to economic partners.

### **Significance of the Study**

The population of South Asia comprises one fifth of the whole world. The population of the region is suffering from severe social problems like poverty, health issues, illiteracy etc. The conflict and arms race between India and Pakistan has further aggravated the situation. In the last few years, the realization among the people has been seen that economic trade among South Asian countries in general and between India & Pakistan in particular can be very fruitful for the

regional stability. In this regard it is very essential to conduct a study about the prospects for trade liberalization between India and Pakistan.

## **Literature Review**

The conflict between India and Pakistan has always been an important and interesting subject for local academic writers as well as for the foreign scholars. Many article and several books have been written over Indo-Pak conflict and its implications for the socio-economic development in the region. The availability of data on the aforementioned subject is also diverse and sufficient enough that it covers all the aspects of conflict between India and Pakistan and its affects for the regional stability. One can also find a handful data related to the challenges to trade liberalization between India and Pakistan, future prospects and potential advantages and disadvantages for Pakistan's economy. Most of the writers are very concerned about the persistent tension and presence of unresolved issues between India and Pakistan especially in presence of devastating capability of nuclear weapons. Some of the writers are optimistic regarding the prospects of trade liberalization and its impact on the Indo-Pak relations. However, the consensus among the experts of South Asian region exists that normalization of relations is going to be tough task given the strategic culture of both countries and for that to happen the leadership of both states will have to contribute positively.

Stephen P. Cohen who is considered to be the premier international scholar and expert on the South Asian region has described the factors that have made the conflict between India and Pakistan intractable in his recent book titled 'Shooting for a Century'. This book could be considered as a comprehensive piece of academic writing that focuses and analyses the deep rooted historical bitter experiences of both nations with each other. It also describes the cultural

and strategic differences that have caused the chances of normalization bleak and would continue to do so in the future as well. He is of the opinion that the historical trends of both nations and complexity of the issues between these rival states suggests that the relations of both countries would remain hostile even in 2047 that marks the hundred years of independence of both states. He believes that to improve relations both countries would have to work bilaterally and there should be nominal role played by the US. He mentions that only once the mediation role was accepted during the Raan of Kutch issue and its result made both parties dissatisfied as strong criticism was faced by the leadership of both countries from their public. He is of the opinion that Indian attitude towards normalization with Pakistan have always been complex. He further adds that Pakistani thinking regarding its relationship with India differs from its neighboring state as its approach is very ideological in nature. As far as the role of trade in Indo-Pak relations is concerned, he is of the view that significant number of people in India believe that through economic means Indian can successfully engage Pakistan to normalize relation and it would have positive impact on the Indian security. Few people also have keen interest in normalizing relations with India through trade but the conservatives in Pakistan are very apprehensive about this phenomena.

Major General (R) Mahmud Ali Durrani in his book 'India & Pakistan: the Cost of Conflict and Benefits of Peace' is of the opinion that the current regional and global dynamics demand that Pakistan and India must transform their relationship towards greater cooperation. He believes that there are significant economic and political reasons for improving their bilateral ties. He is of the view that both countries cannot aspire to play a larger and significant role in regional or global affairs unless they seek the solution of all outstanding bilateral issues. He says that there was a time of greater trust when both countries agreed to solve the water sharing issue through



Indus Water treaty and had also accepted the international help in their border issue when both countries successfully resolved the Kutch border dispute through a tribunal headed by a Swedish judge. Now the trust deficit is so deep that Pakistan is quite hesitant to reciprocate by granting most favored nation status to India and is apprehensive to trade with it. On the other hand he is of the opinion that India has also refused to go ahead with gas pipe line project from Iran through Pakistan and has preferred the expensive sub-sea route. He is of the view that due to the conflict a large portion of resources are spent on defence expenditure and it has jeopardized the socio-economic sector in both countries. He has suggested the multidimensional approach to normalize the relations and he puts special emphasis on the need to expand the trade between the two states. In this book the writer concludes that confrontation between both countries has resulted in poverty and deprivation for the population of both countries.

Muzaffar H. Syed believes that the Indo-Pak relationship could be considered as the rarest of the rare types of relations in his book 'Indo-Pak Relations'. He says that India and Pakistan are closest neighbor with no natural barriers between them but politically both are at a great distance from each other that has immensely undermined the cultural harmony among the two nations that lived together for centuries. He believes that both countries share historical, cultural, geographic and economic links but their relationship is marked by the mutual hostility and suspicion. He believes that the factors that have caused this suspicion and hostility are the violent partition of sub-continent, Kashmir issue and numerous military skirmishes between India and Pakistan. He writes that both nations have so many factors in common as their cultural values and languages are very similar in nature. There are so many common bonds and the resultant relations at many levels as both countries share a common history, common geography and shared surface. He is of the opinion that strong bond and sense of belonging exist between the diasporas of both

countries and one can find several examples where the people of both countries are living in harmony in foreign countries. He concludes that these similarities should play a positive role and in spite of historical ups and downs in their relationship, both countries should progress in positive manner. He suggests that there should always be a positive note in their bilateral economic and political relations.

The book 'Bridging Partition' edited by Smitu Kothari and Zia Mian tries to cover different aspects and prospects for bringing peace and stability between India and Pakistan. The book portrays that the conflict has adversely affected the common people of both countries and the political leadership has done a great injustice to their people for making the conflict intractable and complex. In the chapter 'Building a Nuclear Disarmament Movement: Learning Lessons since 1998', Achin Malik writes that the presence of nuclear weapons is the gravest threat to the security of both nations and efforts must be made to denuclearize the region. However, he believes that the task is quite difficult and seems impossible given the strong hold and narrative built by the leadership for their own vested interests. However he suggests that to reduce the risk and for nuclear safety there should be de-mating of nuclear warheads and missile components. He says that the governments of both countries need to focus on the socio-economic development of their public rather than spending precious resources on dangerous technologies. He concludes that the severity and spread of poverty and illiteracy means that foreign policy issues are distant from the lives of most people.

The book written by Col (R) S.C Narang titled 'India China & Pakistan: Perceived Differences' covers an important aspect of Chinese factor in the South Asian political and strategic environment. The author believes that economy has been the main factor for the current growing

stature of China and India in the international arena. He says that though China and India has a bitter historical experience and both continue to perceive hostile state to each other but their economic relationship has significantly molded their relationship in a positive direction. He is of the opinion that to maintain their economic progress both states need to enhance their economic cooperation. He is apprehensive regarding the nature of Chinese relationship with Pakistan and considers a significant potential challenge for Indian security. He is of the view that these three nations can play a significant role for regional stability through economic cooperation in Afghanistan. He says that economic interdependency of these states could significantly transform the hostile political environment into the cooperative political and strategic environment that would lead to socio-economic development in the region.

Mohsin S. Khan a senior fellow at Peterson Institute for International Economics says in his article 'India-Pakistan Trade: A Roadmap for Enhancing Economic Cooperation' that the improvement in economic relations can significantly help in reducing the tension and would create a conducive environment for negotiations to resolve the political issues between India and Pakistan. He is of the view that since 1990s strong urge has been witnessed in both countries to expand the economic cooperation. Both countries even had taken few very significant steps to liberalize the trade relations. In this regard the Lahore declaration was a significant development that had paved the way for trade expansion between these rival states. However the kargil war and 2002 military standoff between Indian and Pakistan forces jeopardized the prospects for normalization of the relations. He considers the 2005 meeting between Musharaf and Singh the most important development for the economic cooperation when both states agreed to expand their economic ties. However the progress has been very slow due to the trust deficit between the two nations. He says that after the democratic transition in Pakistan; there is another window of

opportunity to increase their economic ties. He suggests that for the liberalization of the trade both countries should first undertake short term measures followed by medium and long term. The purpose of short term measures like relaxing the Visa restriction and other people to people contact related measures should be the confidence building between the two nations.

Nabiha Gul a lecturer at Karachi University says in her 'Enhancing Indo-Pak Trade: Perspective from Pakistan' that the structural differences both countries lack commonalties and convergence in their economic policies. She says that though the economy of both countries is agriculture based but Indian economy has shown significant progress in comparison to Pakistan. She says that the political stability, active diplomacy and consistent economic policies has enable India to rapidly increase its growth rate. On the other hand political instability, weak democratic system, reliance on external borrowing and remittance are the major factors for the low economic growth in Pakistan. She describes that currently three types of trade is being occurred between India and Pakistan. These types include official, non-official and illegal trades. The official trade is conducted under the government policies and it is very limited due to the political hostilities. The non-official trade is being conducted through third party mainly UAE which results a huge loss for the both countries in terms of the potential benefits they could have if done through official channels. The third illegal trade is rapidly increasing, undermining serious economic benefits for states and increasing the chances of drug trafficking and terrorism.

Jülide Yildirim & Nadir Öcal have tried to evaluate the impact of arms race between India and Pakistan on their economic growth in their article 'Arms Race and Economic Growth: The Case of India and Pakistan'. The writers are of the view that both countries indulged in conventional arms race and since their nuclear test in 1998, both countries are also spending a huge amount to

expand their nuclear arsenals and developing the missile system capable of delivering nuclear warheads. They are of the opinion that the spending is even increasing in spite of an aggravated socio-economic development in both countries. The article advocates that though the current impact on the Indian economy is nominal but in longer run it would affect Indian economic development. It further says that the impact of arms race would be more severe for Pakistan due to its small size of economic potential.

Irfan Ahmad and Javeria Sharif have optimistic views regarding the economic liberalization between India and Pakistan in their paper 'The Changing Face of Pakistan's Economic Relations with India and Bangladesh: Prospects and Challenges'. The writers are of the opinion that trade holds the key tool for achievement of national interest for every state in the contemporary international political environment. They further add that India, Pakistan and Bangladesh are very vital for each other due to the factors like historical links, economic interactions and geo-strategic interests. Ethno cultural proximity in addition with aforementioned factors provides golden opportunities for close, cordial and cooperative relations between these three countries. The article describes that positive attitudes exist on both sides to alter the hostile relationship through expanding economic cooperation. It further says that the critics are still skeptical about this trend and proclaim that another incident like Mumbai terrorist attack can shatter the whole prospects for economic liberalization. But irrespective of political constraints, the expansion in economic relations is inevitable to the realities of current nature of globalized international political environment.

Review of the literature suggests that most of the scholars agreed that the hostility between India and Pakistan has jeopardized the socio-economic development in the region. It is also the fact

that the rivalry emanating from several core issues is deep rooted and it would take decades to bridge the gap of trust between the two cousin nations. However, it is agreed that economic liberalization could play a key role in normalizing the relations between India and Pakistan.

## **Hypothesis**

The Liberalization of trade would play a significant role in normalization of relations between India and Pakistan in hostile strategic environment.

## **Research Method**

The study would follow the analytical and qualitative methods of research. To conduct the research, secondary sources are utilized in the form of books and articles to achieve the objective of study. For effective and updated information the internet sources are also consulted. Intensive research work has been done in the area that provided a comprehensive insight to the topic and opportunity to conduct an effective research and make a valuable contribution to the existing literature.

## **Division of the Study**

The Study is divided into five chapters. The first chapter gives an overview of the issue and builds the scenario for need and significance to conduct the study on the role of trade in normalizing Indo-Pak relations. The second chapter provides the theoretical framework for the study in which different cases would be looked into in which trade has been an instrument in transforming the relations of rival states. The third chapter mainly focuses on the conflict between India and Pakistan. The fourth chapter explores the common grounds for India and

Pakistan in trade sector and would analyze the pros and cons of trade from Pakistan's perspective. The fifth chapter describes the future prospects along with offering recommendations for Pakistan's policy makers regarding its relationship options with India. The last part of the study concludes the debate.

## Chapter 2: Theoretical Framework

Inter-state economic cooperation dates back to the origination of political entities, however, its culmination reached at the dawn of the first era of globalization, a process of global interconnectedness through trade in the last decade of 19<sup>th</sup> century. In addition to associated prosperity in trade for the parties involved, it has also become a major factor in resolving political and military conflicts among warring states. The link between trade and peace is well articulated by a famous French Political scientist, Montesquieu in these words: “The natural effect of trade is to bring about peace. Two nations which trade together render themselves reciprocally dependent; for if one has an interest in buying, the other has an interest in selling; and all unions are based upon mutual needs.”<sup>2</sup>

Liberal thought in political science states that increasing trade flows and the prevalence of free trade and democracy should limit the incentive to use military force in inter-state relations. This vision, which can partly be traced back to Kant’s *Essay on Perpetual Peace* (1795), has been very influential: The main objective of the European trade integration process was to prevent the killing and destruction of the two World Wars from ever happening again.<sup>3</sup> It has been established by numerous studies by various political scientists that trade has weakened political and military conflicts by enhancing the cost of conflict as compared to the benefits of peace and cooperation. Rational thought advocates that, however, war can be a tool to pursue foreign policy objectives and benefits of peace outweigh the costs of war comparatively. Peace time offers two countries better conditions of engagement in terms of trade and economic cooperation. War, according to the liberalism, is not inevitable and that human nature, being good, is capable

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<sup>2</sup> Charles Montesquieu, “*The Spirit of Laws*”, (London: Bookfellers, 1794), p. 119.

<sup>3</sup> Philippe Martin and Mathias Thoenig, “Make Trade not War?”, *The Review of Economic Studies*, Vol.75, No.3, 2008, pp. 865-900.



of moderating it through institutional reform and collective action.<sup>4</sup> Economic cooperation and Trade are the, most important and beneficial collective action that two conflicting states can pursue in order to neutralize the imminence of wars.

Free trade and market are the main pillars of liberal theory of international relations. It puts a substantiate importance on free trade. According to the liberal theory, commerce can reduce conflict. This idea has roots in the works of Immanuel Kant, Montesquieu, Adam Smith, Jean Jacque Rousseau and David Hume. As David Hume puts it, “nothing is more favourable to the rise of politeness and learning than a number of neighbouring and independent states, connected by commerce.”<sup>5</sup> This view was later underscored by the Manchester School of Political economy that gave a strong rebuttal of the assertion that military conquest produces economic prosperity.

The doctrine that free trade helps prevent disputes from escalating to wars derives its strength from several propositions. Firstly, commercial engagement creates a concrete incentive to resolve disputes peacefully: War reduces profits by interrupting vital economic exchanges. Secondly, urban business elites that benefit most from these exchanges make a powerful transnational interest group with a stake in promoting peaceful resolution of the conflicts.<sup>6</sup> In addition, the network of trade between countries enhances communication, weakens national selfishness, and encourages both sides to eschew the path of confrontation that is destined to bring destruction and ruin equally to each warring side.

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<sup>4</sup> Karen A.Mingst, “*Essentials of International Relations*”, (New York: Norton & Company Inc., 2003), pp. 63-64.

<sup>5</sup> Charles W. Kegley, Jr. and Shannon L. Blanton, “*World Politics: Trend Transformation*”, (Boston: Wadsworth Publishing), p. 38.

<sup>6</sup> Ibid., p. 4

Benjamin E. Goldsmith applied the framework of relationship between international trade and interstate conflict onset and escalation that incorporates distinct roles for trade volume and trade interdependence. In his study he applied the trade-conflict dynamics model in East Asia, a region that has seen unprecedented volume of trade; he found that with increasing volume of intra-regional trade the chances of escalation of conflict have decreased considerably.<sup>7</sup>

The concept of Crusoe economy draws a link between economic interdependence, trade and aggression. Crusoe economy is known in common economics as a small society with one individual on an island who faces decision-making under limited resources and in this another individual is commonly added to see its effects on the decision-making of the first individual. According to Crusoe economics an economy is imagined with two individuals, X and Z, to assess the conditions under which the two will choose to trade with each other. First, there must be a situation where there is a division of labour and both individuals must have specialization in the production of different goods.<sup>8</sup>

There are three reasons out of which the specialization occurs for X and Y. Firstly, differences in suitability yield of the nature given factors. Secondly, differences in given capital and durable consumers' goods. Thirdly, there should be differences in skill and the desirability of different types of labour.<sup>9</sup>

In the presence of any differences in the aforementioned factors the value of participating in the division of labour increases. The two conditions, division of labour and specialization, augment

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<sup>7</sup> Benjamin E. Goldsmith, "Different in Asia? Developmental States, Trade, and International Conflict Onset and Escalation," *International Relations of Asia Pacific*, Vol. 13, 2013, pp.175-205.

<sup>8</sup> Emiel Awad, "*Economic Interdependence, Trade and War: A Theoretical and Empirical Analysis*" (Netherland: Erasmus University Rotterdam, 2013), p. 3.

<sup>9</sup> Gerard Casey, "*Murray Rothbard*", (New York: The Continuum International Publishing Group Inc., 2010), pp. 33-34.

the total amount of produced goods. In principle, both the trading states should be able to benefit from this augmentation in production. It is proposed that when the division is inclusive enough to include a wide range of products; economic interdependence can be relatively high. Moreover, this situation fosters mutual benefits for two parties increase with the level of economic interdependence.

In a system characterized by division of labour involving multiple individuals and attainment of mutual benefit through voluntary exchange, there is a sufficient motivation for potential aggressors to not recourse to aggression. When one state decides to attack the other state and wins the war then the state that loses the war will simply decide to end all future relations with the aggressor. It is because the victim realizes that whatever it produces may be lost in case of the other state's aggression. So when the economic interdependence is high, the value of the opportunity cost increases for multiple reasons.<sup>10</sup>

According to liberalism, states are economic welfare maximizers. For liberals, governments show high response to the domestic political demands for economic welfare. Mere survival is neither the only nor the utmost important goal for states. Given the fact that economic welfare and economic growth are more important, the loss of trade after a war, and the costs associated with the use of military force lead to a smaller incentive for war. Bilateral relations based on free trade and peace are more conducive to achieving national goals, so that economic interdependence increases both welfare and the desire for peace. Those national economies that are based on autarky are inefficient while those national economies based on free trade and participate in international division of labour are efficient. It is against this backdrop that it is

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<sup>10</sup> Ibid., p. 37

beneficial for states to eschew the path of war and seek the way of peaceful co-existence in order to gain as much as possible benefits from the international division of labour.<sup>11</sup>

Allowing bilateral trade is depended upon whether bilateral relations are friendly. In case these relations are not friendly, states do not get ready for trade because doing trade will help a potential enemy. War, in an environment of free trade and peace, leads to a complete breakdown of bilateral trade. Liberals state that, war may bring some short-term benefits but the long term costs associated with it may override the short-run benefits, so that the likelihood of war decreases along with an increase in economic interdependence. Modern liberalism, also called neo-liberalism, is characterized by a greater willingness on the part of the state to take an active part in the economy. This willingness has often tended the state to regulate the marketplace so that supply of essential goods and services to every state can be ensured.

The post-World War II era is characterized by the principle of economic interdependence among the countries, even those who had fought wars. In international relations, economic interdependence, according to Awad, is symmetrical economic dependence between countries.<sup>12</sup> In an environment of high economic interdependence, the producers and consumers depend on the economic activity in areas beyond their borders. In their seminal work, *Power and Interdependence*, Joseph Nye and Robert Keohane have distinguished sensitivity and vulnerability on the part of states in making themselves economically interdependent. According to them sensitivity entails the size of the effect of economic activities in the one country on the other. On the other hand, vulnerability dimension of interdependence entails the availability and costliness of the alternatives that actors face. A state is vulnerable when it has no alternative to

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<sup>11</sup> Ibid., p. 30

<sup>12</sup> Op. cit 7. p. 15.

trade with a certain state.<sup>13</sup> The vulnerability aspect has mostly been focused. Economic interdependence is believed to be beneficial as it brings mutual benefits for the cooperating states. It is also argued that in an interdependent system states will tend to eschew the path of confrontation and conflict because they are vulnerable and the punishment imposed by the other state is more severe. After reviewing liberalism; the realist theory will be reviewed in the following paragraphs with regard to economic interdependence. Realist thesis argues and emphasizes that economic interdependence must lead to war, however, liberal thesis, as elucidated above, argues that economic interdependence is beneficial in the long-run for the states. It is thus important to understand the dual nature of economic interdependence. On the one hand it has implications for wealth and prosperity and on the other hand it has implications for political power for states.

According to neo-realists, trade and economic interdependence lead to war. They point to the fact that economic interdependence brings great costs to a state by making it more vulnerable by making other state more powerful. Giving the main theme of neo-realist stance on trade and economic interdependence, Kenneth Waltz says, “Close interdependence means closeness of contact and raises the prospect of occasional conflict. Interdependent states whose relations remain unregulated must experience conflict and will occasionally fall into violence. If interdependence grows at a pace that exceeds the development of central control, then interdependence hastens the occasion of war.”<sup>14</sup>

Realism argues in the light of the above proposition of Waltz that states thus avoid to become dependent economically because such a dependency results in great risks. Particularly the last

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<sup>13</sup> J. Nye and R. Keohane, “*Power and Interdependence*”, (California: Longman , 2011), pp.10-13.

<sup>14</sup> Kenneth Waltz, “*Man, the State and War*”, (Columbia: Columbia University Press, 1959), p.138.

part of the aforementioned quote demonstrates the focal point of neo-realism. If interdependence increases to a level where it grows beyond the control of a state, the chances of war increase because swift growing of interdependence puts the future of a state on stake. Waltz opines, “Because states are in a self-help system, they try to avoid becoming dependent on others for vital goods and services.”<sup>15</sup> To realists the threat of survival is always there and it must be overarching other goals a state seeks. In the presence of a threat of extinction to state, economic welfare does not wield any importance. It is because economic interdependence is not as important as military objectives.<sup>16</sup>

Though realists concede that free trade brings advantages which may be lost after the trade stops, they underscore the significance of relative gains and losses in a state’s decision-making. In order to ensure its survival through balancing, a country may decline to cooperate even if it brings absolute benefits. Security of survival is determined by relative power and survival and interdependence in turn depend on a state’s efforts and thus its relative capabilities.<sup>17</sup>

As above of the theoretical framework establishes a strategic relationship between economic interdependence and war, application of game theory will be helpful in order to this complex relationship. States are deemed as rational and unitary actors by both neo-realism and neo-liberalism. Both these theories assumes that states are capable of making rational calculations about the costs and benefits of certain actions and are also able to see the strategic repercussions of their actions. Like Crusoe economics, game theory provides percipient insights by simplifying the real word and displaying a real world situation as a game.

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<sup>15</sup> Ibid., p. 5.

<sup>16</sup> Op. cit. 7, p. 16.

<sup>17</sup> Op. cit. 7, p. 18.

The model starts with the identification of the players, pay-offs, set-up and information sets. Given this done once, conclusions can be drawn about the prospective actions to be taken by the players. Such is also the case when we analyze economic interdependence and war with the help of this model of game theory. When it comes to economic interdependence and war, the players face a Prisoner's dilemma scenario with respect to each other's actions. This subsequently leads us to conclude that the pay-offs of mutual peace are higher for both players than the pay-offs of mutual war. Moreover, it also reflects that the players have a benefit in being deviant of mutual peaceful outcome as long as the other chooses peace as an option. In such a scenario, the aggressor has a relative advantage while the player against which aggression is leveled is worse-off than the mutual peace-outcome and also worse off than the mutual war-outcome. War, in such a scenario, thus dominates the option of peace.

It is not necessary that states always face a Prisoner's Dilemma. There can be a scenario as well in which the option of war does not dominate the option of peace and the aggressor does not gain by abandonment. However, such a scenario is not relevant to the subject of this thesis because in such situation economic interdependence cannot have any pacifying effect. This thesis aims to show that economic interdependence introduces a long-run cost that may supersede the short-run benefit of war. In the absence of such a short-run benefit of war, the long-run cost does not matter.

Conceptualizing free trade and autarky, we assume that states become better-off under the conditions of free trade than they are under autarky, however, realist would contest this proposition and argue to the contrary. Moreover, states in the pursuance of some short-run gains find it beneficial to disallow free trade and subsequently impose tariffs to staunch trade. Such a

policy leads to an extreme position in which states become autarkic where bilateral trade vanishes. This is an extreme position which should not be realized in real world scenarios; however, this makes the model at hand work in a better way. In order to show how economic interdependence affects a state's decision-making in choosing the policy of free trade or interstate war, an extreme and simple perspective of bilateral relations is used in the course of this thesis.

Summarizing the model, it has been showed by the model that the difference between realist and liberal theory can be explained through game theory. It has been shown that states have a larger incentive in cooperating when dependence is higher when liberal assumptions hold. Abandonment of trade may be beneficial in the short-run but in the long-run the higher costs implies a reason for cooperation. The cost of trade abandonment increases as the economic dependence increases that is the more states are economically dependent the more it is costly for them to abandon cooperation and go for war. The presence of such an incentive is dependent upon a range of factors. The first factor is the certainty of future cooperation on the part of other state. In the absence of such a certainty, the peaceful implications of economic interdependence are decreased. Second is the goal of option of war on the part of one state. The option of war should not lead to the elimination of the other state. In the absence of such a conviction, there will be no future punishment for the aggressor and in this case economic interdependence can only lessens the cost of war. Third factor is the time. Time preference on the part of both states should be sufficiently low such that states should be sufficiently patient so that conditional cooperation can be possible. If this factor is absent, states tend to look only to the present, and the present gains aggression, overriding a glance at the long-run costs of aggression. Moreover, economic interdependence may tend to increase the chances of war in a situation where states



focus only about the present short-run gains. Fourthly, trade should be exorbitantly important for states, otherwise the long-run costs of disallowing trade may not produce an impact. The fifth factor, the final and the most important of all factors, is the primary difference between the theories of liberalism and realism. One theory assumes that economic interdependence increases the level of absolute gains for both players. However, the other theory stipulates that when states care about their relative gains, the economic interdependence plain the way of aggression between the States.

Principally speaking, there is a possibility of synergy between the two theories. An overview of the existing literature on the subject gives a variety of different views about the effects of economic interdependence on the likelihood of war. The two theories, liberalism and realism, have different perspectives and underscore different factors discussed in the above model. If the theorists find a middle ground on the application of theory on data, there is a possibility of a confluence between the two theories. Like in the Copeland's analysis, it can be argued that the effect of economic interdependence on bilateral conflict is sufficiently depended on the specific situation that states find themselves in or face that situation.<sup>18</sup>

Globalization and its subsequent prevalence have ascended liberal economy over mercantilist economy. Globalization refers to the increasing importance of the global level of analysis in economics, as the scope of economic activities expands worldwide. Global interconnectedness has resulted in interdependence through trade and economic cooperation. There are at least three competing conceptions about globalization. According to the first view, globalization is the realization of the liberal economic principles. A global market place under free trade has brought

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<sup>18</sup> Op. cit. 7, p. 33-34.

growth and prosperity to countries that are economically most integrated. Second view holds a contrary conception to the first one and skeptic of the successes of globalization. It argues that world's major economies are no more integrated today than before World War I. The skeptics subscribing to this view also doubt that regional and geographical distinctions such as North-South divide are vanquishing in favour of a single global market. To the contrary they see the gulf between South and North is increasing with globalization and the economic integration of states may be leading not to a single world free trade zone, but to distinct and rival regional blocs in America, Europe and Asia. Third school of thought finds a middle way between the earlier two. It views globalization as more profound than the critics believe. The proponents of this school of thought also call Transformationalists; say that state sovereignty has been eroded by the European Union, World Trade Organization and other new institutions, so that sovereignty is no longer an absolute just one of a spectrum bargaining leverages held by states.<sup>19</sup>

Allen in his review of Balassa's cornerstone book, *The Theory of Economic Integration*, describes that the basic ingredient of any integration form is the elimination of barriers to trade among two or more countries. He also underscores the point that a separate theoretical framework is needed to study the issues of economic integration despite the fact that the conventional international trade theory has dealt with effects of reduction of trade barriers. According to Balassa, there are four different stages of economic integration. The first is a Free Trade Area (FTA), then a Customs Union (CU), then a Common Market (CM), and lastly an Economic Union.<sup>20</sup>

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<sup>19</sup> Joshua S. Goldstein and Jon C. Pevehouse, *"International Relations"*, (New York: Pearson Longman, 2006), pp. 175-180.

<sup>20</sup> Amr Sadek Hosny, "Theories of Economic Integration: A Survey of the Economic and Political literature," *International Journal of Economy, Management and Social Sciences*, Vol.1, N0.5, 2013, pp. 133-155.

There are three different methods of dealing with the question of “gain” from trade. First, the doctrine of comparative costs, under which economy in cost of obtaining a given income was the criterion of gain. Second, increase in income as a criterion of gain. Thirdly, terms of trade as an index of the international division and the trend of gain.<sup>21</sup>

The doctrine of comparative costs holds that under the free trade environment each country in the long run moves to specialize in the production of and to export those products in whose production it enjoys a comparative advantage in terms of real costs, and to gain through import those products which could be produced at home only at a comparative disadvantage in terms of real costs, and that such specialization is to the mutual advantage of the countries involved in it.<sup>22</sup>

Heckscher-Ohlin (H-O) model of factor proportions states that a country will have a comparative advantage in exporting the products that require factors of production that are relatively abundant and therefore relatively cheap within its borders. The factor-price equalization theorem originating from the H-O model states that countries with different factor endowments and at different level of development and different per capita income are expected to trade with each other the most, and that the prices of the factors of production will tend to converge between the two countries after trade or integration occurs. However according to Linder’s hypothesis countries should enjoy more trade potential if they have similar per capita incomes or different per capita incomes according to the comparative advantage theory or the H-O model.<sup>23</sup>

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<sup>21</sup> Jacob Viner, “*Studies in the Theory of International Trade*”, (London: Bradford and Dickens, 1960), pp. 455-459.

<sup>22</sup> Ibid., p. 9.

<sup>23</sup> Ibid., p. 8.

Explaining regional economic integration Dion says, “Regional economic integration concerns three different actors: the two insiders and the one outsider. Each actor having its specificities, we henceforth consider that each differs from the two others in terms of its stock of human capital. In that case, its stock of knowledge will also be different as its output growth. However, by trading and opening their economy to the exchange of goods, services and ideas, union members can increase their stock of knowledge by benefiting from the stock of their trading partners (contained in their partners’ exports). The lowering of transaction costs (in the sense of barriers to trade and to commercial transactions) is one of the most efficient way of acquiring knowledge both private and public either through relocation of activity or increase in trade volumes.”<sup>24</sup> The lowering of transaction costs and the elimination of trade barriers are primary ways to integrate the economies and promote trade liberalization. These steps not only foster economic integration but also ensure a smooth and immediate supply of goods to and from other countries.

Following economic integration in different continents of the world, the global economy becomes less concentrated since the centripetal forces have weakened. In the context of South Asian region, there has been little success in the area of economic integration with SAARC playing a tame role in paving way for the trade liberalization among the countries of the region. The path of regional economic integration is staunch by the persistent conflict between the two most important countries of the region: Pakistan and India. Being the two most important players in the region, India and Pakistan have to normalize their relations and promote an economically integrative approach in strengthening the capacity of SAARC. The success stories of ASEAN in

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<sup>24</sup> David-Pascal Dion, “Regional Integration and economic development: A Theoretical approach”, Discussion Paper No.20, Governance and the Efficiency of Economic Systems. pp. 2-3.

the East Asia and NAFTA in North America suggest a bright future for regional economic integration.

Pakistan and India have not yet been able to normalize their bilateral relationship that is characterized by various full scale wars and economic and military standoffs. History of this conflicting relationship has proved that wars have not been able to solve the longstanding core issues between the two countries. However, this conflicting relationship has impeded the path of trade liberalization and promotion of bilateral trade between the two countries. A theoretical approach explained above has proposed that if the economic interdependence increases it will increase the cost of war for both the countries. Once the option of economic interdependence through inclusive trade liberalization is adopted it will not only lessen the likelihood of wars in future but better the socio-economic conditions of both the countries.

The model related to trade and national development creates an appreciable ground for the liberalization of trade between India and Pakistan. On the one hand India is the second most populous country on earth and Pakistan has a huge population that is increasing at a pace incomparable by another nation on earth. The two countries' huge spending in the defence sector has made governments of both countries to ignore the issues like poverty, education and health. There has been gradual but a persistent increase in defence expenditures of both India and Pakistan since the independence in 1947 and both continue to spend more and more in their respective defence sectors. The increasing defence expenditures have resulted in the negligence of the important socio-economic issues. It is in the interest of the people of both India and Pakistan that the two countries increase economic interdependence through the principle of trade liberalization. Economic interdependence will increase the cost of aggression and thus the

defence expenditures can be cut down and more and more money of taxpayers will be used in eradicating poverty, illiteracy and health related problems.

### **Chapter 3**

#### **Pak-India Strained Relations**

Pakistan and India are dominating factor in each other's threat perceptions and formulation of their security policies. The persistent conflict between them has not only jeopardized their trade relations but has also adversely affected their own socio-economic development. The history of conflict is longer and deep rooted. Since the partition of Sub-continent the Indo-Pak relations have been strained and are marked by continuous hostility between the both neighboring states. According to Stephen Cohen the conflict between India and Pakistan is the world's most complex and long lived similar to the conflict between Israel and Arabs.<sup>25</sup> However the rivalry between both nations is rooted even before the existing of India and Pakistan. The very basis of Pakistan creation lies on the assumption that the rights of Muslims were in danger under the Hindu rule in India.

Both nations had lived together for centuries but failed to integrate socially and politically in spite of many cultural societies. The religion was the major reason that separated the both nations. And even after independence religion played the significant role in molding the relationship of both countries as it played significant role in shaping their policies particularly in the case of Pakistan. The politics of religion resulted into massacre of Muslims, Sikhs and Hindus migrants from each other. The Indian subcontinent witnessed the worst communal riots

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<sup>25</sup> Stephen P. Cohen, "*Shooting for a Century: Finding Answers to the India-Pakistan Conundrum*", (Washington D.C: The Brooking Institution Press, 2013), p. 8

in the history of world. The most ironic aspect is that both nations were not involve in any major communal violence when they lived together for centuries but were involved in severe mass killing of each other when they decided to live separately.

The conflict that was rooted in their national identities was further expanded into territorial and border disputes soon after their independence.<sup>26</sup> The unfinished partition in case of Kashmir and several other princely states along with the issues of distribution of assets laid the foundation of chronic conflict between two populous countries of South Asia. The Kashmir issue has been the major cause of conflict between India and Pakistan that led to war between them within one year of their independence followed by three major wars and several crises in the later years. The military confrontation led to heavy spending of defence as both countries were actively indulge in building strong military muscles. Pakistan being the smaller state threatened by strong enemy sought the foreign help that resulted the foreign interference in formulating its foreign policy and in some cases even its internal policies.<sup>27</sup>

Even after sixty eight years of independence, both states are failed engage each other diplomatically to end their conflict. In fact with the passage of time the scope and dimensions of conflict between Indo-Pak have increased and conflict has become more complex and damaging.<sup>28</sup> Currently both countries other than territorial disputes have water issues, issue of terrorism and issue of arms race between them. This chapter would discuss the major disputes, causes and dimensions of the conflict between India and Pakistan. The chapter would also discuss the major peace efforts between India and Pakistan and their impact. The possible

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<sup>26</sup> Ibid.

<sup>27</sup> Ibid.

<sup>28</sup> Ibid.

conflict resolution mechanisms and future prospects of Indo-Pak relations would also be highlighted in this part of the study.

### **Major Wars between India and Pakistan**

India and Pakistan have fought three major wars along with one limited war at Kargil in just 60 years since their independence. Moreover, both nations also came several times closer of military confrontation especially during the 1980s and 90s over the Kashmir issue. The first major war between India and Pakistan was fought over the Kashmir issue soon after the independence. The war broke out when the Kashmiri ruler sought the help of Indian forces against the resistance by the Kashmiri armed resistance groups helped by the fighters from Pakistan province of NWFP. The war came into end in 1949 when UN called for cease fire and asked both India and Pakistan to hold referendum in the Kashmir to know the will of Kashmiri people.

The second war was fought in 1965 and the cause was again the Kashmir issue. The armed mission of the freedom fighters backed by the Pakistani army threatened to occupy the Kashmiri territory controlled by the Indian army. India became under pressure and decided to expand the war theater and attacked Pakistan at Lahore border. The war ended in a stalemate and the strategic status quo was reinforced after both countries signed the Tashkent agreement to formally end the war. The war of 1965 left long term implications as for as the prospects for peace were concerned in South Asia. The trust deficit between India and Pakistan grew wider and strong feelings of enmity prevailed among both nations for each other.<sup>29</sup>

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<sup>29</sup> Mahmud Ali Durrani, *India & Pakistan: The Cost of Conflict and The Benefits of Peace*, (Karachi: Oxford University Press, 2001), p. 12.



The third major war between India and Pakistan occurred in 1971 that not only changed the geographic landscape of the region but also paved the way for induction of nuclear weapons technology in the South Asian region. India exploited the ongoing turmoil in East Pakistan and launched military offensive which resulted in breakup of Pakistani state and the new state of Bangladesh came into existence. The loss of East Pakistan shocked the whole Pakistani nation and their hatred for India increased rapidly.<sup>30</sup> But most importantly the significant implication of this loss was transformation of Pakistani strategic thinkers' attitude towards the security calculus. Pakistani policy makers now firmly believed that India would never miss a chance to wipe out Pakistan's existence and the alliance with foreign powers is not going to help against the stronger enemy. It was concluded that the only solution to the dilemma of military asymmetry in India's favor is to seek the nuclear weapon capability.<sup>31</sup>

The next significant military conflict between India and Pakistan occurred in the shadows of nuclear weapons known as the Kargil conflict. In 1999, the Pakistani backed militants occupied the Kargil check posts vacated by India due to the severity of weather in winter. India accuses that it was actually the Pakistani military itself that was involved in occupying the Kargil territory. India reacted by the use of heavy military force and both sides suffered heavy casualties. The major threat was the chances of war expanding from limited to full scale war that could have even caused the exchange of nuclear weapons.<sup>32</sup> The international community was deeply concerned and actively persuaded both nations to end the conflict. Due to the active role of US both nations agreed to seize fire after Pakistan agreed to withdraw its troops from Kargil. It was the first test of nuclear deterrence and opinions differ over the role played by nuclear

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<sup>30</sup> Ibid., p. 18.

<sup>31</sup> Ibid., p. 55.

<sup>32</sup> Col. (R) S.C. Narang, *"India, China and Pakistan: Perceived Differences"*, (Delhi: Prashant Publishing House, 2012), p. 125.

weapons in this conflict. One opinion is that the deterrence worked as the conflict remained limited in spite of all odds indicating the full fledged war between India and Pakistan. The other opinion is that nuclear weapons failed to refrain India and Pakistan to indulge in military confrontation and the deterrence did work but little.<sup>33</sup>

Other than fighting the major wars, there were occasions when both countries came eye ball to eye ball in fighting another conflict. In late 1980s and early 90s when the insurgency in Kashmir grew stronger, both nations several times deployed their armies and conducted military exercises that mounted high tensions on both sides of the border. But the real threat of war occurred in 2001-02 military standoff between India and Pakistan. India in response to the attack on its parliament blamed Pakistan and threatened to launch military offensive inside its territory to destroy the alleged networks of terrorists. Pakistan equally prepared itself and deployed its military on border to give suitable response to Indian aggression. The tension was only defused after the international community pressurized both countries to show restraint and urged Pakistan to take appropriate action against the extremist groups.<sup>34</sup> In response Pakistan did take action against groups with mission to carry out terrorist activities inside Indian territory and banned several militant outfits.

The most recent chances of military conflict came in the wake of Mumbai terrorist attacks in 2008. India accused that the terrorist were of Pakistani origin and had been supported by its intelligence agency. Indian threatened to carry out surgical strikes inside Pakistani territory. Pakistan immediately condemned that attacks and offered India for its full cooperation to trace the culprits behind this act of terrorism. Pakistan's positive and responsible response helped to

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<sup>33</sup> Ibid., p. 128.

<sup>34</sup> Ibid., p. 286.

defuse the tension; however the relations between both countries remained cold afterwards. The biggest drawback of this incident was the suspension of Composite Dialogue between India and Pakistan.

### **Causes of the Conflict**

The causes of conflict between India and Pakistan range from partition legacy to territorial disputes and water issue. Moreover, with the passage of time the causes have been increasing like the policy of India and Pakistan to have greater influence in Afghanistan and alleged role of both states in fueling the insurgencies in each other's territories. The root cause of the conflict is embedded in the perceptions of both nations about each other. The basis of the conflict lies in the history of clashes between the Indian and Muslim nationalism during the British rule in India. The congress party led by majority of Hindu leadership was unwilling to accept the due share of political participation of the Muslims of Indian sub-continent. The Muslims felt their social, cultural and political identities and rights threatened in India governed by Hindu leadership. Therefore, they demanded the separate homeland for the Muslims of Indian subcontinent. The Hindus saw the demand of separate homeland as a betrayal and were unwilling to accept the division of Indian 'motherland'. This scenario led to beginning of rivalry between the two nations and sowed the seed of hatred that has been growing consistently.

The events surrounding the partition further caused the friction between the both nations. Thousands of people were forced to move and hundreds were slaughtered during the partition on both sides. The Indian refusal to ensure transparent division and transition of assets to Pakistan caused further enmity between the leadership of both countries. The vision of both countries leadership also deserves the strong criticism as the earlier years of relationship between India and

Pakistan were very crucial for the future generations of Indian subcontinent.<sup>35</sup> Unfortunately, the political leadership wasted the golden opportunity of providing the basis of relationship based on cultural and geographical bindings and the future generations are now suffering and would keep suffering in foreseeable future. The most important factors leading to conflict between India and Pakistan are the territorial and border disputes between both countries. The water issue is also another major source of tension between India and Pakistan.

### **Territorial Disputes**

The demarcation of border between India and Pakistan was the biggest challenge faced by the British during the partition of India. For this purpose the British rulers announced the commission that was headed by Cyril Redcliff. There were about 680 princely states during the partition that were being governed by the local rulers. The states were allowed to accede with India or Pakistan and even had the option to remain independent. But these princely states were restrained by the geographical, administrative and resources limitations to remain independent. Therefore most of them acceded with India and Pakistan depending on the religious and geographical realities. However in the case of some states the situation was complex and therefore caused the dispute between India and Pakistan. In this regard the states of Junagadh, Hyderabad and Kashmir caused the serious friction between India and Pakistan. The Kashmir dispute has been the major cause of deadly conflict between India and Pakistan that involves the wars and crisis between both states. The Kashmir issue would be discussed in detail in the next heading. The dispute over Junagadh and Hyderabad is dead but it is important to study since it had caused mistrust and laid the foundations of hostilities between the two nations.

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<sup>35</sup> T. V. Paul, "Why has the India-Pakistan Rivalry Been so Enduring? Power Asymmetry and an Intractable Conflict", *Security Studies*, Vol. 15, No. 4, 2006, pp. 600-630

The Junagadh state consisted of Hindu majority population but was ruled by a Muslim ruler. The state was also physically separated from Pakistan but it could still have been linked with Pakistan through maritime since at one side it had coastline. The ruler of Junagadh Nawab Mahabat Khan decided to accede with Pakistan and Pakistan had also accepted its accession. But India refused to accept this accession and decided to include it in its own territory through the use of force. India sent its troops to invade Junagadh and declared it as the part India. Pakistani leadership strongly condemned the Indian move but was not in a position to take the military option into account.

The state of Hyderabad was another source of dispute between India and Pakistan. The ruler of Hyderabad was Muslim but the majority of its population was Hindus. The ruler of this state wanted to remain independent but India through the use of force occupied it.

Moreover, the Pakistani leadership was of the view that Cyril Redcliff misused his authority and the areas of Muslims majority were wrongly included in Indian territory.<sup>36</sup> The areas handed over to India that Pakistan objected includes the Gurdaspur, Ferozpur and Jullander. Pakistani leadership believed that the purpose was to provide India a gateway to the state of Jammu and Kashmir. Pakistani founder Muhammad Ali Jinnah termed the award as “an unjust, incomprehensible and even perverse award”.

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<sup>36</sup> Ibid.

## Kashmir Issue

The Kashmir conflict is a territorial dispute between India and Pakistan over the Kashmir region, the northwestern most region of South Asia.<sup>37</sup> India officially claims that Kashmir is integral part of India and it is only willing to grant autonomy to extent as Indian constitution permits.<sup>38</sup> Pakistan has contested this Indian claims and believes that Kashmir is still the unfinished business of partition. Currently India controls the 63% part of Kashmir and Pakistan control the 37% part of the region. The Kashmir issue has been the major bone of contention between India and Pakistan. Both countries have fought three wars and faced several military stands off on this issue.

The state of Jammu and Kashmir is the Muslim majority state where around 78% population follows the religion of Islam. However the ruler of Kashmir was Hindu and he was reluctant to accede either with India or Pakistan. Therefore he offered a 'stand still' agreement to both India and Pakistan which meant that both states would respect the independence of the Kashmir. The Pakistan had accepted this proposal but India refused it. The Kashmir was strategically very important to Pakistan as all the major rivers of Pakistan flow from the Kashmir. In this regard Muhammad Ali Jinnah had termed the Kashmir as the 'Jugular Vein of Pakistan'. The Pakistan's point of view is that the people of Kashmir wanted to accede with Pakistan and in this regard demonstrations were held in favor of Pakistan. The Hindu ruler wanted to suppress their demands through the use of force which resulted in armed rebellion against the ruler. The people from North West Frontier Province (NWFP) also participated and were successful in freeing a large part of Kashmir which is currently administrated by Pakistan. The Maharajah of Kashmir

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<sup>37</sup> Muzaffar H. Syed, "*Indo-Pak Relations*", (New Delhi: Orange Books International, 2012), p. 16.

<sup>38</sup> Ibid.

felt threatened to lose his rule and asked India for help. India in return of assurance of accession sent its troops to curb the movement.<sup>39</sup> This led to a declared war between India and Pakistan in 1947. India soon moved the matter to United Nations which asked both parties for cease fire. The UN Security Council also passed the resolution to hold plebiscite in Kashmir.

Both India and Pakistan accepted the right of Kashmiri people of self determination. But since then India has been reluctant to take steps to organize the plebiscite. The Indian version is that Pakistan failed to withdraw its troops from its controlled Kashmir. The failure to seek the permanent resolution led to another major war of 1965 between India and Pakistan. In early 1990s the struggle in Kashmir turned violent and armed struggle was initiated against the Indian occupation. India accused Pakistan of fueling insurgency in Pakistan and the relations of both countries remain very tense throughout the decade of 90s. The Kashmir issue became the major reason for nuclearization of South Asia.<sup>40</sup> It has been the major foreign policy objective of Pakistan to highlight the Kashmir issue at international forums. Pakistan also wanted to discuss the Kashmir issue with India in all the diplomatic efforts to solve the issue between India and Pakistan through diplomacy. In this regard Pakistan has also sought the mediation role of other powers as well to solve this issue. Pakistan's insistence to include Kashmir issue as a priority in dialogue with India and Indian reluctance to talk about Kashmir has seriously hindered the resolution on other relatively less complex issue between the two states.<sup>41</sup>

India and Pakistan have been involved in several attempts to resolve the Kashmir issue but the extreme positions of both countries on the issue have resulted in non settlement of the issue.

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<sup>39</sup> Col. (R) S.C. Narang, Op.cit., p. 98.

<sup>40</sup> T. V. Paul, Op.cit.

<sup>41</sup> Ibid.

Pakistan has been very keen to seek the help of international community to play its due role and has even welcomed the role of UN and other countries to play the role of mediator, In contrast India is opposed to any third body's intervention and claims that the Simla agreement has made the UN resolution irrelevant and as per this agreement both countries would resolve the issue through bilateral negotiations. Pakistan's official stance on this Indian claim is that pronouncing bilateral negotiations between Pakistan and India on Kashmir as undermining UN Security Council's resolutions was legally and politically incorrect and the Simla Agreement does not make UN resolutions ineffective.<sup>42</sup> Pakistan's position on resolution of the Kashmir issue is that dispute must be resolved as per the aspirations of Kashmiri people through plebiscite.<sup>43</sup>

### **Siachen Issue**

Siachen conflict between India and Pakistan is considered to be least complex and easily resolvable according to most of the security experts. However the inflexibility shown by India on this issue has halted any progress to solve the crisis.<sup>44</sup> This is the only issue on which Indian army has publically declared its position to oppose any settlement calling for its withdrawal and Pakistan army has shown flexibility by publically announcing that it would welcome a solution of this conflict.<sup>45</sup>

The conflict of Siachen is about the military deployment on Siachen glacier that is undefined border area between India and Pakistan. The glacier remained no man's land till 1984 until India added a new dimension into already volatile conflict between India and Pakistan by deploying its

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<sup>42</sup> "India Inflexible on Siachen Issue: Pakistan", *Daily Times*, October 02, 2014.

<sup>43</sup> Ibid.

<sup>44</sup> Ibid.

<sup>45</sup> Stephen Cohen, Op.cit., p. 126.



forces on the glacier. This conflict is also considered to be the highest battle ground on earth. Since 1984 hundreds of soldiers have been died on both sides mainly not due to military skirmishes but due to the harsh weather conditions. In 2012 Pakistan lost its 140 soldiers when a massive ice avalanche struck a Pakistani military headquarters at Gayari. To sustain the military presence on the glacier the financial cost is also very heavy as both countries annually spend millions of dollars. Pakistan has also accused India that its military presence on the glacier has been polluting the water that flows into its territory when the snow melts in summer.

The efforts have been underway for the settlement of the dispute and many Indian even agree that during the era of Rajiv Gandhi the settlement of the conflict was reached and its announcement was postponed till his reelection but his unfortunate assassination caused the delay that eventually could never be accomplished.<sup>46</sup> The security experts are of the opinion that Indian army and its public has second thought on the issue and is opposed to the idea of vacating the glacier.<sup>47</sup> On the other hand Pakistan including its military is very keen for the settlement of the issue especially after the Gayari tragedy in 2012. Pakistan states that it only deployed its forces on the Glacier when India provoked it by occupying the Siachen glacier heights and the settlement of the issue would be beneficial to both countries.<sup>48</sup> During an interview the defence minister of Pakistan stated that Pakistan is always willing to sit on the table to discuss the issue. He termed the ‘egos of both armies’ the biggest hurdle in reaching the agreement on Siachen conflict.

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<sup>46</sup> Ibid., p. 49.

<sup>47</sup> Ibid., p. 78.

<sup>48</sup>“Egos, armies of India, Pakistan biggest hurdle to Siachen peace: Mukhtar”, available at <http://tribune.com.pk/story/388052/egos-armies-of-india-pakistan-biggest-hurdle-to-siachen-peace-mukhtar/>

## **Sir Creek**

Sir Creek, a 96km narrow piece of water between India's Gujarat state and Pakistan's Sind province, is a contentious issue, which has plagued the two nations relations for decades. Pakistan claims its right on the territory in the light of its historical relevance. In 1914, during the dispute between Sind and the Kutch Durbur, both parties reached on the agreement that concluded the Sir Creek to be controlled by Sind. In the backdrop of that agreement Pakistan claims that since Sind is now part of it, therefore as per international law it has inherited the right over Sir Creek territory. The experts are of the opinion that the territory is of no military value therefore the dispute remained cold over the years between India and Pakistan. But the territory has a huge economic significance due to the potential resources of oil and gas. Therefore in age of economic development as a primary concern for every state the dispute is very relevant to the normalization of relationship between India and Pakistan. The existence of sea laws further adds the importance of the territory.

The efforts to resolve the issue have been underway since 1969 but the inability of both states to show flexibility has led to persistence of tension over this issue as well. Like other issues, Pakistan has been proposing the mediation but India insist on bilateral negotiations. The problem with bilateral negotiations is that the trust deficit is huge between both nations. Moreover, both states are always hesitant to show any flexibility on the reason that the other party would take this as a weakness. The chances of any progress on the issue are very diminish since the current Prime Minister Narendra Modi has been opposed to the idea of discussion with Pakistan during the time he was Chief Minister of Gujrat. During the time when an interior minister was on Indian tour and possibly on the talks of Sir Creek issue with Indian officials; CM Narindra Modi

wrote a letter to Prime Minister to express his apprehensions and said that giving the territory to Pakistan would be a strategic blunder. Both countries have been indulged in preparing for maritime warfare in this backdrop of this dispute. In the future if both countries failed to solve the dispute, the Sir Creek issue could cause serious tensions in Indo-Pak relations.

## **Water Disputes**

Water issue between India and Pakistan is another major source of tension that could potentially be a major factor of future war between India and Pakistan. All the major rivers in Pakistan start from the Indian occupied disputed territory of Kashmir. Therefore Pakistan fears the Indian capacity to control the flow of water hence creating serious economic crisis in Pakistan since agriculture sector of Pakistan is the backbone of its economy. Soon after the partition the water issue became a major reason of hostile relationship between India and Pakistan. On 1st April 1948, India had stemmed the flow of tributaries to Pakistan and discontinued water to the Divalpur canal and main branches of Upper Bari Doab Canal.<sup>49</sup> This development resulted into strong reaction and frustration from Pakistan. However the leadership of both countries realized the severity of the issue and decided to solve the issue amicably. The negotiations were started in 1951 and with the help of World Bank both countries reached to conclude a treaty called Indus Basin Treaty (IBT). According to this treaty the Six Rivers were divided between India and Pakistan with each having the rights of water of three rivers. The Eastern rivers the Beas, Ravi and Sutlej were given to India and the Western rivers the Indus, Chenab and Jhelum were given to Pakistan.<sup>50</sup> However India being the upper riparian has also the rights to use the water of the Western rivers for the purpose of irrigation and transportation as well. But India cannot reduce

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<sup>49</sup> Mohammad Jamil, "Indo-Pak Water Dispute", *Pakistan Observer*, January 15, 2011.

<sup>50</sup> Ibid.

the flow of the water to Pakistan. According to the treaty, in case of any dispute the World Bank would appoint an arbitrator whose decision would have to be accepted by both India and Pakistan.<sup>51</sup>

The increasing value of water resources for agriculture and power generation as well as the scarcity of it along with environmental issues has made the water issue very sensitive between India and Pakistan. Pakistan has been facing acute shortage of water and Indian move to build more dams on the Western rivers has caused great anxiety among the Pakistani leadership. Water is so important factor for Pakistan that many analysts believe that water could be the main reason of future war between India and Pakistan. Moreover, water is also one of the red lines of Pakistan's nuclear threshold.<sup>52</sup> Pakistan has reservation over three projects carried out by India which includes the Baglihar dam, Kishanganga dam and Wular Lake barrage.<sup>53</sup>

However, U.S. Senate Foreign Relations Committee report concluded that no single dam would affect Pakistan's access to water but it did say that these projects would increased the Indian capacity to control the flow of water during the crucial times.<sup>54</sup> On the other hand India has rejected Pakistan apprehensions regarding Indian efforts to control the flow of water and says that it has no intention or desire to do so. But the trust deficit between Indian and Pakistan is so vast that both countries remain skeptical about the intentions of each other. Pakistan fears that during the time of crisis Indian authorities can seriously paralyze Pakistan's irrigation system by controlling the flow of water. Therefore it is not ready to allow India to build the capacity of controlling the flow of water. The water issue has also been used as a tool to oppose the

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<sup>51</sup> Ibid.

<sup>52</sup> Stephen P. Cohen, Op.cit., p. 112

<sup>53</sup> Niharika Mandhana, "Squaring Off Over Their Rivers", available at <http://content.time.com/time/world/article/0,8599,2111601,00.html>

<sup>54</sup> Ibid.

normalizations of relations with India by the hardliners in Pakistan. The hardliners in Pakistan has propagated it as Indian water terrorism. If both countries do not build consensus on resolving the water dispute; the normalization of relations would be hard to achieve and the tensions would increase given the increasing water scarcity problem in Pakistan.

### **Afghanistan Issue**

Afghanistan is another front of hostility between India and Pakistan. Afghanistan is very crucial for the regional security and economic prospects. Both India and Pakistan have been skeptical of each other's intentions and desired role in this country. India and Pakistan have been contending for the favorable conditions in Afghanistan since their independence.<sup>55</sup> Initially the relations remained hostile between Pakistan and Afghanistan and India exploited the situation in its own favour and established good relations with the government in Afghanistan. The security analysts believe that both countries have been engaged in proxy wars in Afghanistan to undermine the other's security interests. Pakistan's initial experience with Afghanistan made it conscious of Indian role in its neighborhood and afterwards Pakistan tried to contain its influence consistently. Pakistan sees Indian policy in Afghanistan as a policy of encircling its territory and instead desires to make the Afghan territory to increase its security by supporting the factors in Afghanistan that are more favorable to Pakistan.<sup>56</sup> In this regard Pakistan chose to support the Taliban rule in Afghanistan after the Russian withdrawal.

Even in the current scenario the hostility between India and Pakistan lies at the heart of the current war in Afghanistan. Pakistan is very concerned regarding the India's growing role in

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<sup>55</sup> Mungo Melvin, "Learning the Strategic Lessons from Afghanistan", *The RUSI Journal*, Vol. 2, No. 157, 2012, pp. 56-61

<sup>56</sup> Ibid.

Afghanistan. Pakistan believes that motives behind Indian heavy investment are to support anti Pakistani elements in the country to undermine Pakistan's security interests. Pakistan has not only unilaterally opposed the Indian activities but has also urged the international community particularly US to keep check on Indian activities in Afghanistan.

On the other hand India accuses Pakistan for the alleged attacks on its diplomatic and rehabilitation mission in Afghanistan. India claims that Pakistan has not dropped the idea of strategic depth and is still using the Afghan territory to promote its security interests even through the means of proxy war and supporting the terrorist elements. A large number of neutral analysts see the increasing role of both states with suspicion.<sup>57</sup> They are of the opinion that for India and Pakistan, the Afghan territory is mere another front where the military and economic stakes of both countries are very high. India is actively engaged in increasing its influence by establishing several consulates in many parts of Afghanistan particularly near the Pakistan's border. India is also using these diplomatic missions as a cover up for its intelligence operations in Afghanistan. On the other hand Pakistan in search of favorable elements is even supporting the Taliban.

For Afghanistan both India and Pakistan are very crucial for its security, stability and economic prosperity.<sup>58</sup> The country is already going through turmoil and the proxy war between India and Pakistan would further complicate the situation for the Afghani people. The chances of increase in hostile relations between India and Pakistan in Afghanistan are very high. Both countries would try to fill the void created by US withdrawal by supporting and promoting their own agendas. However, the new government in Afghanistan and international community led by US

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<sup>57</sup> Ibid.

<sup>58</sup> Ibid.

could play a decisive role in persuading the leadership of both countries to contribute constructively in Afghanistan. Both India and Pakistan themselves also need to realize that the hostility and proxy war in Afghanistan would not only increase the problem for Afghan people but it would also seriously jeopardize the peace and stability as well as the economic development of the South Asian region. By extending cooperation and addressing each other's concerns India and Pakistan can not only ensure their own security and economic interests but they would be contributing significantly for the peace and stability in Afghanistan.<sup>59</sup>

### **Cross border Terrorism and Fuelling Separatist Movements**

The hatred for each other between Indian and Pakistan is deeply integrated and both countries have been accusing each other for making deliberate attempts of weakening each other by exploiting the internal political instability and by fueling the separatist movements in each other's territory. India had accused Pakistan for its alleged support to the Sikh armed struggle against Indian rule in East Punjab known as Khalistan movement. But most importantly India accuses Pakistan for fueling the insurgency in Kashmir and helping the terrorist to carry out terrorist activities inside Indian territory. Blaming Pakistan for supporting Kashmiri insurgents and planting terrorist networks in India is so serious and significant that it has become a public rhetoric to seek the public support for Indian politicians in their political campaigns. For last one decade the major Indian demand to Pakistan has been to stop cross border infiltration if Pakistan wants to engage in serious dialogue with India.

India had directly blamed Pakistan for attacks on its parliament in 2001 and threatened to take military action against Pakistan. This led to serious diplomatic tension between India and

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<sup>59</sup> Ibid.

Pakistan that resulted military standoff between the nuclear armed neighboring states. The next crucial phase of tension between India and Pakistan came after the Mumbai terrorist attacks which again threatened to the occurrence of military confrontation between India and Pakistan. On the other hand Pakistan also blames India for fueling insurgency in Baluchistan and even playing crucial role in instigating sectarian and ethnic violence in Pakistan.

Though blaming the rival state has been the most suitable available excuse for the leadership of both countries to hide their own weaknesses as well as to divert the attention of their publics from the real issues, nevertheless there is an element of truth in their accusation of cross border terrorism and fuelling separatist movements. The intelligence agencies of both countries have been involved in the activities of carrying out terrorism acts during the decades of 80s and 90s to destabilize and weaken the enemy state. Though the issue of Baluchistan is largely internal problem and is largely caused by the failure of Pakistani state to address the grievances of Baluch people, however India has took this opportunity to pressurize Pakistan and to use it as a bargaining chip to refrain Pakistan from supporting the insurgency and separatist movements in Kashmir. It has been the major policy goal of India to portray Pakistan as a failed state that is unable to cope with its domestic ethnic, sectarian and security challenges.

On the other hand Pakistan frustrated by stubborn Indian leadership policies on the solution of Kashmir problem had allowed the militants from Pakistan to participate in armed struggle against Indian forces in Kashmir. During the 1990s it was quite normal for the militant groups to propagate their notion of Jihad and request the public for funds and recruitments. The militants group fighting against Indian forces had developed infrastructure in Pakistani territory and in some cases had even the support of Pakistani security forces. However, the incident of 9/11



changed everything and the post 9/11 security environment made it difficult for Pakistan to allow its territory for militants' safe heaven. Therefore following the military standoff between India and Pakistan, the Musharraf government banned some of the militant organizations and also pledged for not allowing its territory to be used against the cross border terrorism.

But the terrorism in South Asia is not the problem of one country alone and it has become a regional problem. There are militant outfits in both countries that operate freely and are beyond government capacity to be controlled. They also have the political agendas that do not support the normalization of relations between India and Pakistan. In this regard the attacks on Samjhota express by the Hindu extremist group and Mumbai attacks by the Pakistan based Muslim extremist group are few examples. But the irony is that the dialogue process between the neighboring states has become hostage to these extremist elements. The composite dialogue between India and Pakistan brought significant improvement in their relations in the context of lowering the trust deficit and enhancing people to people contacts but one terrorist attack ruined the several years' hard work of the diplomats and foreign delegations of both states.

The way forward for both countries is to realize that fueling the insurgency in each other's territory to create instability would only undermine their own security. The terrorism has become a grave threat that poses equally bigger challenge to the prosperity of both India and Pakistan. Both countries cannot bring breakthrough in normalizing their relations if they continue to allow the terrorists to spoil the whole progress through the acts of terrorism.<sup>60</sup>

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<sup>60</sup> Sukanta Acharya, "Security dilemmas in Asia," *International Studies*, Vol. 44, No. 1, (March 2007), pp. 57-72.

## **Competing International outlook**

India and Pakistan have also been competing for their regional and international outlook to maximize their political sphere which has at times caused tension among their bilateral relations. India aspires to become the global power and considers seeking more active role in international bodies including the permanent membership of UN Security Council (UNSC).<sup>61</sup> Pakistan has been very apprehensive regarding the India's growing regional and international clout and its leadership is concerned regarding India's 'hegemonic' designs. Pakistan openly opposes the idea of making India as a permanent member of UNSC on the grounds that India should resolve its disputes with its relatively 'weaker' neighboring states. Pakistan maintains that membership of UNSC would further inflame Indian hardnosed relationship with its neighboring states. Pakistan considers itself the real challenger to Indian 'designs' of regional hegemony.<sup>62</sup> In response Pakistan also seeks the international role more than its capacity. Pakistan for a long time had considered itself to lead the Muslim world. Pakistan played an active role in formulation of Organization of Islamic countries. Pakistan also blocked the Indian membership of OIC and has used the platform of OIC to mount pressure on India to seek the resolution of Kashmir issue.

## **Treaties and Summits between India and Pakistan**

The history of Indo-Pak relations has been full of tensions and conflicts but there have also been efforts made by the leadership of both countries to resolve the issue through bilateral means. Even there have been instances of remarkable proposals made by the both countries to each other like treaty of friendship by India, no war pact by Pakistan, nuclear weapons free zone South Asia

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<sup>61</sup> Ibid.

<sup>62</sup> Ibid.

by Pakistan etc. Though these proposals were rejected by the other parties, nevertheless there have been few success stories that mainly include the Indus Water Treaty, Tashkent Declaration that ended the 1965 war and finalization of several CBMs between India and Pakistan. But most important diplomatic agreements and efforts by the leadership of both countries that need to be described in details are the Simla Agreement, Lahore Declaration and Composite Dialogue between India and Pakistan. These diplomatic engagements have long lasting impact on Indo-Pak relations as well as they explain the complexity of Indo-Pak disputes that would take generations to seek the permanent resolution of these disputes.

### **Simla Agreement**

The agreement was signed between Pakistani President Zulfikar Ali Bhutto and Indian Prime Minister Indira Gandhi in Simla, India following the 1971 war between India and Pakistan which resulted in creation of Bangladesh as an independent state. According to this treaty both countries agreed to resolve their bilateral issue through peaceful means. The agreement converted the cease-fire line of December 17, 1971 into the Line of Control (LOC) between India and Pakistan and it was agreed that "neither side shall seek to alter it unilaterally, irrespective of mutual differences and legal interpretations".<sup>63</sup> The major points in Simla agreement both countries agreed were the following:<sup>64</sup>

- That the principles and purposes of the Charter of the United Nations shall govern the relations between the two countries.

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<sup>63</sup> Muzaffar H. Syed, Op.cit., p. 155

<sup>64</sup> Ibid.

- That the two countries are resolved to settle their differences by peaceful means through bilateral negotiations or by any other peaceful means mutually agreed upon between them. Pending the final settlement of any of the problems between the two countries, neither side shall unilaterally alter the situation nor shall both prevent the organization, assistance or encouragement of any acts detrimental to the maintenance of peace and harmonious relations.
- That the prerequisite for reconciliation, good neighborliness and durable peace between them is a commitment by both the countries to peaceful coexistence respect for each other's territorial integrity and sovereignty and noninterference in each other's internal affairs, on the basis of equality and mutual benefit. That the basic issues and causes of conflict which have bedeviled the relations between the two countries for the last 25 years shall be resolved by peaceful means.
- That they shall always respect each other's national unity, territorial integrity, political independence and sovereign equality.
- That in accordance with the Charter of the United Nations, they will refrain from the threat or use of force against the territorial integrity or political independence of each other.

### **Lahore Declaration**

The Lahore declaration was a significant initiative taken by the leadership of both countries to normalize their bilateral relations in the wake of dangerous post nuclearized South Asia. This

declaration was also the major force behind the occurrence of peace process between India and Pakistan. In the year of 1999 the Indian PM visited Pakistan via bus and signed this historic declaration with his Pakistani counterpart. In this agreement both countries agreed that their respective governments:<sup>65</sup>

- shall intensify their efforts to resolve all issues, including the issue of Jammu and Kashmir;
- shall refrain from intervention and interference in each other's internal affairs;
- shall intensify their composite and integrated dialogue process for an early and positive outcome of the agreed bilateral agenda; and
- shall take immediate steps for reducing the risk of accidental or unauthorized use of nuclear weapons and discuss concepts and doctrines with a view to elaborating measures for confidence building in the nuclear and conventional fields, aimed at prevention of conflict.

### **Composite Dialogue**

The roots of the Composite Dialogue Process date back to May 1997, when at Male, the capital of Maldives, the then Indian Prime Minister Inder Kumar Gujral and his Pakistani counterpart Nawaz Sharif mooted the idea of a structured dialogue or the Composite Dialogue Process (CDP). Based on a compromise approach, the peace process enabled the two countries to discuss

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<sup>65</sup> “Lahore Declaration”, available at <http://www.nti.org/treaties-and-regimes/lahore-declaration/>, retrieved on 15 August, 2014.

all issues including Jammu and Kashmir, simultaneously.<sup>66</sup> Since its inception, the dialogue process has gone through numerous highs and lows in bilateral relations. It has remained susceptible to unforeseen incidents which have derailed the process several times in the past.<sup>67</sup> Currently this Composite Dialogue is suspended by India after the Mumbai 2008 terrorist attacks in which India alleges Pakistan for its hand.

This peace process covered several sectors that included peace and security, Kashmir, Sir Creek, Siachen, Waller Barage, economic cooperation, terrorism and cultural exchange. This composite dialogue played a crucial role in normalizing the relations between both countries and the people of both countries had high expectations from this process that they believed that this would help both countries to resolve their bilateral disputes peacefully. However the progress of this process remained significant only to the people to people contact as more people got the visas to visit their relatives as well as few bus services were also started to operate between India and Pakistan. The progress on Kashmir issue remained zero and even the issues such as Siachen and Sir Creek could not be resolved. But the optimists were of the view that the enmity of more than fifty years was so deep that it will take time when both countries would start trusting each other and termed the process significant for the future relationship between nuclear armed states.

However the Mumbai attacks shattered all hopes and all the little progress made by the peace process was once again wasted. India has suspended the composite dialogue and has asked Pakistan that it will remain so until Pakistan does not punish the culprits behind these terrorist attacks even as well as ensures that its territory would not be used for the future terrorist attacks

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<sup>66</sup> Sajad Padder, "The Composite Dialogue between India and Pakistan: Structure, Process and Agency", Heidelberg Papers in South Asian and Comparative Politics, Issue 65, 2012.

<sup>67</sup> Ibid.

against India. Pakistan has tried several times and has even sought the help of US to convince India for the resumption of Composite Dialogue. In the current situation, the issue looks bleak as the recent clashes at border has further increased the problems for the political leadership to resume this composite dialogue.

## **Conclusion**

In this part of the study the major disputes and causes of the conflict between India and Pakistan is discussed. The study has identified that the seeds of the conflict between India and Pakistan can be traced back to the pre-partition era. The legacy of partition has further supplemented the hostility between the both nations. The hostility has caused four major wars and several military standoffs between India and Pakistan. The issue of Kashmir is the major bone of contention and the relations of both countries cannot be normalized without solving this issue. The other major issue between India and Pakistan that are threat factors leading to conflict are the water disputes, Afghanistan issue, Sir Creek, terrorism and Siachen. The study has also described the major diplomatic efforts between India and Pakistan and has concluded that the trust deficit is so deep that these efforts could achieve nothing significant. The relations of India and Pakistan could easily be hijacked by the terrorist groups by employing even a minor terrorist event.

## Chapter 4

### Economic Cooperation: Impediments and Opportunities

#### **Pak-India Economic Cooperation: an overview**

Bilateral trade between India and Pakistan is considered by certain quarters on both sides of the border as the most important confidence building measure in normalizing the strained relationship. In addition to being the most important confidence building measure, bilateral trade is believed by some to be the only way to transform the strained bilateral relations to friendly bilateral relations.<sup>68</sup> It is theorized in this research that bilateral trade can not only help normalize the strained relations but also can serve as the first constructive step in the peaceful resolution of all outstanding issues between the two estranged countries.

Not more than a year after their independence from a foreign colonial power, India and Pakistan entered a conflict-ridden course of relationship starting the first war over Kashmir in 1948. To address the questions that how and who started the war is beyond the purview of the study at hand, nevertheless, it is noteworthy to mention that due to this war the possibility of bilateral trade remained a remote course of action on the part of each warring state in the subsequent years. The period between 1947 and 1971 is marked by three wars between the two states that once shared a common history of struggling against a colonial power. This period experienced a low level of bilateral trade given the fact that the two countries were busy most of the time fighting against each other.

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<sup>68</sup> Stephen P. Cohen, *Shooting for a Century: Finding Answers to the India-Pakistan Conundrum*, (India: HarperCollins Publishers, 2013), pp. 75-110.



However, there was a positive dimension in the bilateral relations right after the partition of British India too. Shortly after the partition India was the most important trading partner of Pakistan. The percentage of Pakistan's exports to India in 1948-9 was 56 per cent and 32 per cent of Pakistan's imports was coming from India.<sup>69</sup> Two important developments resulted in the decline of bilateral trade and interdependence at that time: Currency devaluation in India and subsequent imposition of trade restrictions by Pakistan. Setting aside the old age interdependence, the two governments followed a path of diminishing interdependence to readjust the self-constructed political realities. Bilateral trade that started right after the partition culminated and ceased as a result of 1965 Indo-Pak war. Since then the bilateral trade has not been resumed in the sense as it existed before the war, however, it has resumed in fits and starts. Trade related legislation in both countries has further reduced the volume of trade for it allows bilateral trade based on a restricted list, which puts restrictions on the type of items to be traded bilaterally. Due to this legal restriction, there has been a surge in the illegal trade through smuggling of goods from both sides of the border. Even the security forces deployed on both sides of the border are accused to be involved in trans-border smuggling. This illegal trade has been, however, beneficial to the villages bordering from both sides of the border.<sup>70</sup>

The situation of bilateral trade improved as a result of a trade agreement in 1975 between the two states. This improved the level of bilateral trade but did not lead to complete mutual agreement encompassing all aspects of bilateral trade. However, it was the government of Pakistan that did proactively announced a positive list of 40 items for trade. During the 1990s, a period which saw a return of civilian rule in Pakistan after more than a decade, the bilateral trade increased often

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<sup>69</sup> Dr. Ijaz Nabi, "Integrated Report and Summary of Findings, Pakistan India Trade Study", Ministry of Commerce, Government of Pakistan, September 1996, p. 2.

<sup>70</sup> Op.cit., pp. 41-42.

punctuated by fluctuations. This increase in bilateral trade was as a result of two important policy decisions aimed at liberalizing bilateral trade: Both India and Pakistan joined World Trade Organization in 1995 and in 1996 India granted MFN status to Pakistan.

These developments were followed by another important development in 2004 when both India and Pakistan signed South Asian Free Trade Agreement (SAFTA). By signing this multilateral agreement the developing countries in the SAARC region agreed to decrease the tariffs to a 0-5 per cent level by 2013. Coupled with General Pervez Musharaff initiation of trade talks with India, this agreement helped bilateral trade reach a record high figure. The issue of bilateral trade since then has been given special attention with it encompassing the academic, policy and diplomatic circles in both countries.

A major development since 2011 has been the annulment of the Positive list and announcement of a negative list by the government of Pakistan. This negative list enables more products to be traded through road and increased from 40 to 137 products.<sup>71</sup> However, Pakistan has still not been able to reciprocate the Indian decision to grant MFN status to Pakistan in 1996. Pakistan's reluctance to grant the MFN status to India is viewed by the latter as a violation of the SAFTA. PPP-led government decided principally to reciprocate the Indian gesture by giving it MFN status but this has still not been realized. As the official bilateral trade is minuscule limited by the positive list, the unofficial trade has grown between the two countries. This informal trade is carried out via a third country, especially UAE and it is estimated at some two billion to three

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<sup>71</sup> An S.R.O. No. 280 was issued by Pakistan's Ministry of Commerce on March 20th, 2012, which entails the list of 1209 items not importable from India. It also has the list of 137 items which are allowed to be traded via land route. To find out the list see <http://www.tdap.gov.pk/.php> In Jan 2014, an item Petroleum Coke was also permitted to be traded through Wagah-Attari border. See <http://www.dawn.com/news/1079280/import-of-petroleum-coke-allowed-by-road-from-india>.

billion dollars per annum.<sup>72</sup> In addition to it, as mentioned earlier, there are number of items that are illegally traded across the border benefiting the illegal traders on both sides of the border.

Since the last four decades, both Pakistan and India have proved more open economies. Indian GDP's share of global imports and exports has raised from 10 per cent in 1970 to 32 per cent in 2010.<sup>73</sup> Similarly Pakistan's share has also increased from 12 to 34 per cent. A realization of gains from the global trade has been observed on part of the both countries.

However, increasing global trade on part of the two countries has not reflected in case of their bilateral trade between the two countries. The table below elicits that Pakistan's exports to India are small both in scope and magnitude- only one per cent of global exports and a small amount of Indian imports. Similarly exports of India to Pakistan constitute only 1 per cent of its total exports. There has been no advancement in potential trade because of the strained political relations between the two countries.

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<sup>72</sup> Nabiha Gul, "Enhancing Indo-Pak Trade", Issue Brief, Institute of Peace and Conflict Studies, (September 2009), pp. 2-4.

<sup>73</sup> Hafiz A. Pasha, Muhammad Imran, "The Prospects for Indo-Pakistan Trade", *The Lahore Journal of Economics*, Vol.17, (September 2012), pp. 293-313.

**Table 1: Trade between Pakistan and India, 2000/01-20**

**Pakistan's Exports to India**

<b>Year</b>	<b>Exports (USD million)</b>	<b>A percentage of Exports</b>	<b>A percentage of Indian imports</b>
2000/01	56	0.8	0.1
2006/07	344	2.6	0.1
2009/10	268	1.9	0.1
2010/11	264	1.0	0.1

## Indian exports to Pakistan

Year	Exports (USD million)	As percentage of exports	As percentage of Pakistani imports
2000/01	238	0.4	2.7
2006/07	1236	1.1	5.1
2009/10	1226	0.9	4.2
2010/11	1734	0.9	4.9

*Source:* State Bank of Pakistan.

## Current Scenario

The fate of normalization of Indo-Pak relations received momentum when Modi led BJP came into power in May 2014. Pakistan had announced in 2011 to extend the MFN status to India to reciprocate a similar extension by the latter in 1996. Pakistan has renamed the MFN to Non Discriminatory Market Access (NDMA) in a bid to detach the pejorative meaning attached with the MFN in the state and society of Pakistan.<sup>74</sup> To reach a conclusion on granting India MFN or

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<sup>74</sup> J. Whalley, "Non-discriminatory Discrimination: Special and Different Treatment under the GATT for developing countries", *The Economic Journal*, Vol.100, No.403, 1990, pp. 1318-28.

NDMA, the talks between the two countries have been underway but so far have not been able to produce any tangible result because of the recurring tension on Line of Control (LoC) and heating up debates by anti-trade lobbies in both countries.

The latest of round of talks after the resumption of composite dialogue in 2012 were to take place on New Delhi from 25<sup>th</sup> August this year, however, after the Pakistan's high commissioner invited Kashmiri Hurriyat leaders ahead of Pak-India talks, India cancelled the bilateral talks on accusing Pakistan of interfering in India's internal affairs. Variety of hindrances remain in the way of granting India full NDMA status, however, the clear understanding on both sides to normalize bilateral relations through unhindered trade enabled by open borders seems to be a matter of time now.

### **Tariff Policies as Barriers**

One of the major factors behind the low trade between Pakistan and India is the less diversified export base of Pakistan and 60 per cent of its exports are accounted for by two products: agricultural and textiles items. Moreover, these similar items also account for a large amount of India's exports too. It is against this backdrop that free trade between the two countries is inevitable. If free trade is realised there could emerge a degree of specialization between two countries, depending on relative advantage. This can lead Pakistani products from the above two sectors to find a shallow access in the Indian markets.

Tariff policies adopted by India have so far precluded the possibility of intra-industry trade. Intra-industry trade is also affected by support provided by India in the form of relative large

subsidies, especially agriculture.<sup>75</sup> A table is given below that compares the level and pattern of import tariffs in the two countries, showing that custom duties on agricultural items are notably higher in India.

**MFN-applied tariffs by product group in India and Pakistan**

Product group	India	Pakistan
Animal products	33.1	14.6
Dairy products	33.7	30.0
Fruit, vegetables, plants	30.4	18.2
Coffee, tea	56.3	12.8
Cereals and preparations	32.2	18.8

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<sup>75</sup> Ibid.

Oilseeds, fats, and oils	18.3	8.8
Sugars and confectionery	34.4	17.2
Beverages and tobacco	70.8	52.5
Cotton	12.0	7.0
Other agricultural products	21.7	6.7
Fish and fish products	29.8	10.6
Minerals and metals	7.5	12.4



Petroleum	3.8	10.7
Chemicals	7.9	9.6
Wood, paper, etc.	9.1	15.5
Textiles	14.7	16.7
Clothing	13.4	24.8
Leather, footwear, etc.	10.2	14.9
Nonelectrical machinery	7.3	9.3
Electrical machinery	7.2	14.7

Transport equipment	20.7	24.7
Manufactures, n.e.s.	8.9	13.1

**Source:** World Trade Organization, country tariff profiles.

It is noteworthy to note that India also operates a wide range subsidy regime in agriculture. According to Institute of Public Policy, subsidies on agricultural inputs such as fertilizers, water, power, tractors and seeds etc., exceed 5 per cent of its GDP. However, the concomitant percentage in case of Pakistan is 1 percent of its GDP. However, there no denying of the fact that the agriculture subsidies are WTO-compliant, the high magnitude of it in India has made brought the domestic production on competitive path in relation to the imports artificially.

### **Non-Tariff Barriers**

The prevalent viewpoint in Pakistan reflects that India restricts its trade with other countries not only through tariff barriers but Non-Tariff Barriers (NTBs) also.<sup>76</sup> Some of these NTBs have more strictly been applied on Pakistani items. Following pages describe Pakistan and India's operated NTBs.

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<sup>76</sup> Ibid.

## **Indian NTBs**

According to the World Trade Organization, India operates the following significant NTBs:

- Sanitary measures are harmonized with international standards and that engulf mostly food items.
- Complex nature of obtaining import licenses and permits.
- Blockade is imposed on imports of animals and plants.
- Certain goods can only be traded through some specific ports or trade routes and particular agencies.
- Antidumping and countervailing measures are taken actively by India.

## **Pakistan's NTBs**

In comparison with the aforementioned NTBs operated by India, Pakistan operates fewer and less rigorous NTBs that are described below:

- Unlike in India, the main trade policy instrument operated by Pakistan is the tariff regime including sanitary measures rather than NTBs.
- Clearance of items such as pharmaceuticals, agricultural products and engineering goods require clearance from the relevant ministries/industries.

- Restriction on imports is applied for health, safety, security, religious and environmental reasons.
- A dominant role is played by state agencies, TCP in case of Pakistan, in the import of agricultural items.
- Unlike India, it has been seldom that Pakistan embarks upon antidumping and countervailing measures.

Together with tariff barriers, NTBs seem to have impeded and have major impact on the trade between the two countries. At lower level some steps have been taken so far to fare the situation, however, there is still lack of higher level efforts in this connection from both sides. Moreover, it is clear that NTBs are more restrictive in India than in Pakistan, especially on agricultural items. In addition, there are other several impediments to bilateral trade, given they are removed it can lead to a significant enhancement in bilateral trade.

In addition to the technical barriers to bilateral trade, a host of national level political impediments that have significant impact on trade liberalization related endeavours in both countries. Some of these are described below.

### **Domestic Politics**

Domestic politics of both Pakistan and India have a great impact on their respective foreign policies when it comes to the bilateral relationship between these two countries. Kashmir, the main cause for adversarial relations, has taken a stronghold in domestic politics in both countries.

Certain parties and quarters such as rightist parties in both countries champion the issue of Kashmir coupled with nationalistic fervour in their electoral campaigns. The groups and parties on Pakistani side develop a pressure group conditioning the normalization of relations with India with the resolution of Kashmir.<sup>77</sup> However in the current scenario, after coming into power of business friendly Nawaz Sharif, there appears to be cross-party consensus to a certain extent about normalization and strengthening of trade relations with India. Prime Minister Nawaz Sharif has been an ardent supporter of friendly relations with India and called for peaceful resolution of all outstanding issues, including Kashmir, peacefully. It was also a BJP government in India last time when Nawaz Sharif was in power in 1999 and he successfully held Lahore Summit with Indian Prime Minister Atal Bihari Vajpai, who came to Lahore through train. Again with Nawaz Sharif in power for the third time in Pakistan, in India BJP has once again in Power with Narendra Modi at the helm. Though Nawaz has been promoting an agenda of friendly relations with India and even went to the swearing in ceremony of Narendra Modi, there has been no reciprocal response by India. However, Narendra Modi is also trade friendly and wants to see the bilateral trade increased on the one hand while his anti-Muslim actions in past place him at an antagonistic position with Pakistan on the other hand. Nevertheless, both countries seem determined to proceed further and make things happen at least about issues regarding business and trade. A recent meeting in New Delhi between the commerce ministers of India and Pakistan discussed several measures to accept liberalization and facilitation actions. One of the important measures seems to keep the Wagah-Attari border functional round the clock, introduce containerization regarding shipments and grant MFN status as a reciprocal gesture.

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<sup>77</sup> F.S. Aijazuddin, "Divided Attentions", *Dawn*, September 20, 2012.

## **Military's Predominant role**

The most pressing reason India gives for the failure of normalization is the predominant role of the army both in domestic and foreign affairs of Pakistan. Unlike India, Pakistan has made the army a central force in politics and strategic policy.<sup>78</sup> Several military governments in past have hindered the grooming of civilian political leaders in Pakistan. Civilians who had tried in past to challenge the predominant role of army were made powerless by army through military coups. India accuses Pakistan army of anti-normalization and that holding negotiations with the Pakistani civilian leaders is useless because that do not control the foreign policy.

Army, since the inception of the country, held strong views on normalization with India. There is a perception in army that India is an aggressive neighbour that has made several attempts to cripple Pakistan. It believes that trade with India will further strengthen its hegemonic aspirations and Pakistan, being weaker conventionally, will have badly impacted by such a situation. It is evident from the Kargil operation in 1999 which was preceded by Indian Prime Minister's visit to Lahore some months before when the Kargil Operation started. The civilian leadership of that time was taken aback by the army's adventurism at a time when the two countries were about to resolve all issues peacefully.

The issue of granting MFN status to India was not liked and held reservations by the powerful Pakistan army and it seems that the pressure from army has been stalling the realization of MFN extension to India. This led to the government's announcement that the decision to grant MFN

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<sup>78</sup> Stepehn P. Cohen, "The Army," *The Oxford Companion to Pakistani History* edited by Ayesha Jalal, (Oxford University Press, 2012), pp. 58-59.

treatment was only in principle, however, the status would be extended if situation is quite favourable and in the national interest.

### **MFN Issue**

When the World Trade Organization was formed in 1995, both India and Pakistan joined it as members. It is enshrined in the first article of GATT that all the signatories to the agreement are bound to do trade with one another in the light of MFN principle. India complied with the GATT and extended MFN status to Pakistan soon after joining WTO, however, Pakistan has not been able to reciprocate this so far.

Principally the MFN treatment ensures non-discriminatory trading terms among the WTO members. It is based on the principle of guarantee that if favourable tariff rates are given to one trading partner then all the member countries will get the same terms. The principle does not requires extending extra advantages to any trading partner, but rather uniform terms for trading for all member countries of WTO.

However, there is not uniformity among the member countries in obliging these principles and not all countries fulfil this obligation. There are few clauses in GATT that allow one country to discriminate against the other, in addition to the permission to form Preferential Trade Agreements.<sup>79</sup> For example, the United States does not extend an unconditional MFN status to China because of the latter's communist inclinations.

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<sup>79</sup> See Article XX and Article XXI for general exceptions in the text of The General Agreement on Tariffs and Trade formulated in Geneva.

It was in 2011 when Pakistan took a principle decision to accord MFN status to India under a new name, Non-discriminatory Market Access. In 2012, it was decided that the two countries will enjoy mutual MFN treatment from January 2013; however, this has not been materialized. It is expected that the current government of Pakistan will soon fulfil its promise to grant MFN status given the pressure from business community within the country and international donor agencies.

Indian imposed Non Tariff barriers serve as one of the main hurdle in Pakistan's reciprocity of MFN treatment to India. These Indian imposed NTBs are complex and range from quality assurance, physical inspection by custom officials, to visa issuance. NTBs constitute a significant proportion in the composition of the Overall Trade Restrictiveness Index (OTRI) of India. So there needs a policy shift in both countries and the hurdles in the way must be removed for the realization of free trade between the two countries. India needs to shun its policy to impose NTBs on one hand while Pakistan on the other hand needs to expedite the process of realization of MFN treatment to India.

### **Industry Specific Opportunities and Threats**

It has been showed that Trade Liberalization would result in benefits for both the trading countries, however, in case of Pakistan and India the opportunities are coupled with some threats as well. Following paragraphs take into account certain industries that can be faced with threats as a result of trade liberalization between Pakistan and India.



## **Textile and Clothing**

The industry of textile and clothing is a major industry in Pakistan and India alike that plays an important role in the economic dynamics of their respective countries. The goods produced by this industry accounts for a large portion of trade in both countries and contribute 18.8 per cent in India and 65.6 per cent in Pakistan, as per the total value of exports in Fiscal year 2004.<sup>80</sup> Both countries rely hugely on these sectors for the creation of employment opportunities and export revenues.

As of now, trade in textile and clothing between India and Pakistan is so much low as to be considered non-existent. In both countries the textile and clothing sectors elicit different levels of specialization. In Pakistan the specialization of this industry is in cotton textile intermediate goods including towels and bed linen, while Indian firms have developed high expertise in fibre production and garment manufacture and packaging. Firms in both countries are not vertically integrated and most of them are operating as privately owned small and medium sized firms. However, in recent times textile and clothing industry have vertically integrated to some extent.

## **Agriculture**

Agricultural sector keeps a central position in the economies of Pakistan and India constituting a major portion of their exports. Agriculture contributes over 21 per cent to the GDP of Pakistan while Indian agriculture contributes over 14 per cent to its GDP and the sector absorbs 45 per

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<sup>80</sup> “Implications of Trade Liberalization between Pakistan and India”, working paper for conference on Pak-India Trade Potential, Punjab Board of Investment and Trade, May 3, 2012.

cent of Pakistan's and 58 per cent of India's labour force. Agriculture accounts for 17.7 per cent of its exports as compared to India's 8.7 per cent.<sup>81</sup>

As India is the leading producer of wheat and sugar, Pakistan would be in a position to tap substantive gains from trading with it in these items. In addition to major crops such as wheat and sugar, both countries can explore a number of trading opportunities in other food items. Moreover, India also can tap the potential so that it can export the products that Pakistan has been importing from other destinations than India.

### **Automobile**

The automobile industry of Pakistan is characterized by protective measures for a long time now. The industry was given a push towards growth through the Automobile Industry Development Plan (AIDP) in 2008. However, the automobile industry stands second largest in terms of its contribution to custom duty and sales tax, its contribution to the GDP in terms of exports has been relatively small and is growing on a slow pace.

Automobile Industry of India is, to the contrary, one of the most rapidly growing automobile industries in the world, with India bringing innovation in the industry. Indian automobile industry is technologically more advanced and sophisticated as compared to the Pakistan's corresponding industry. Despite Indian automobile industry's sophistication and increasing global auto exports, Pakistan has not been able to benefit from it through imports given the various barriers in the way of free trade being operated by both countries over various different products. If the trade liberalization is realized, Pakistan would be able to import not only Indian

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<sup>81</sup> Ibid., p. 12.

cars and tractors but Pakistan's automotive industry can also benefit the increased exports to grow the national economy also. In addition, Pakistan can also serve as a potential destination for outsourcing of the Indian automobiles.

Pakistan's policy of protection in the case of automobile industry has not brought benefits to the industry and it has been unable to make the industry competitive enough to equalize with the global automobile industry.

### **Pharmaceuticals**

In pharmaceutical sector, India holds an advantageous position as compared to Pakistan. Currently, India has the third largest pharmaceutical industry in the world. The number of pharmaceutical units in India is much larger than in Pakistan, such as India has over 200,000 pharmaceutical manufacturing units while there are only 400 hundred such units operating in Pakistan. The foreign investment in the Indian pharmaceutical sector is also huge with multinational companies investing over \$6 to 10 billion within the last decade alone. On the other hand, though Pakistan's pharmaceutical sector and healthcare sectors are expanding and evolving rapidly, there is still half of its population that does not have access to modern medicines and pharmaceuticals. Given this, Pakistan can get benefits from Indian huge and growing pharmaceuticals through free and liberalized trade with it. In addition, Pakistan can also learn greatly from India in the field of pharmaceutical industry as Indian machinery used in pharmaceutical industry is cheaper than half of the other international suppliers from whom Pakistan imports these machineries.

## **Manufacturing**

The overall share of manufacturing sector in GDP of Pakistan has been higher than in India: In the year 2009-10 18 per cent in contrast to 16 per cent in India.<sup>82</sup> In spite of growing energy shortages and rising inflation domestically, manufacturing industry of Pakistan has showed some positive growth over last five years. There has been 31.3 per cent growth in the India's manufacturing sector in the year 2009-10. Indian chief exports in terms of manufacturing sector are cellular phones, data processing machines, aircraft parts and air conditioning machines.

Pakistan has developed special expertise in manufacturing highly developed and famous sports goods and surgical instruments. Apart from these products, Pakistan is also able to export to India light engineering products.

Like in other sectors, there are various pitfalls in manufacturing sector of Pakistan arising from the weaknesses such as obsolete machinery, lack of standardization, poor quality control practices, meager R&D and the small amount of market capacity. Unless these weaknesses are addressed properly, Pakistan's manufacturing sector will continue to face challenges in realm of export competitiveness, especially against India.

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<sup>82</sup> Ibid., p. 23.

## **Chapter 5**

### **Prospects for Sustained Economic Cooperation between India and Pakistan in the environment of great hostility**

The prospects of economic cooperation between India and Pakistan are great given the socio-economic needs and geographical proximity of the both countries. The volume of trade between India and Pakistan could reach up to about 9 billion dollars which currently is around just one billion dollars. But the important question is that in the environment of military rivalry marked by huge mistrust how can and how much these two countries could strengthen their economic ties. As discussed in the earlier chapters, the current eras is of economic cooperation and through economic ties the old rivals have become today's allies. The world has transformed in a manner where even the adverse states are doing trade with each other in spite of all the political differences. The emergence of regional blocks like European Union on the basis of economic interest is another significant development.

Since the beginning of composite dialogue between India and Pakistan, both countries were on the right track and serious chances prevailed of substantial economic cooperation between the both countries. However, the developments following the Mumbai terrorist attack have overshadowed the trade relations. In the following years the relative calmness has prevailed in the region but the both countries have not formally resumed the composite dialogue. The change of governments in both India and Pakistan was seen as a good sign for the trade relations between the both countries. Both PM Modi and PM Nawaz are considered to be the pro-trade personalities. To prioritize the economic sector and improve economic relations with other

countries was also the major goal in their election manifesto. The Pakistani PM also declared the policy of having good relation with India during his election campaign.

The Nirindra Moodi's decision to invite Pakistani counterpart on oath taking ceremony and subsequent visit of Nawaz Sharief was seen as a positive beginning for the normalization of relations between India and Pakistan. However nothing significant has been achieved thereafter and the formal resumption of composite dialogue is still awaited. The current trends in Indo-Pak relations reflect persistence mistrust between the both nations. Although improving the economic sector has been the major priority of both governments but achieving this goal from enhancing trade with the neighboring country seems the option not being considered.

The economies of both India and Pakistan have huge potential to get benefit from increasing trade with each other. The economic relations can not only be strengthened at bilateral level but also strong regional economic forum could come into existence by using the platform of SAARC. The study has already covered the nature of conflict between India and Pakistan, potential benefits of trade and impediments in economic cooperation. In this part of the study the focus would be on the future scenario of economic cooperation between India and Pakistan. The chapter would discuss the future political environment in South Asia, possibilities of enhanced economic cooperation and policy options for Pakistan.

## **Trade Liberalization under SAFTA**

On January 6, 2004, the South Asian Association for Regional Cooperation (SAARC) member countries, including Pakistan and India, concluded the landmark agreement on South Asian Free Trade Area (SAFTA). The agreement was coupled with a pledge to allow free trade among member countries by removing trade barriers and decreasing their tariffs in two phases, to 0 to 5 per cent from January 1, 2006, onward. This treaty also allows free cross-border flow of goods within the region, albeit the provision for a list of sensitive items for member countries to safeguard national interests.

SAFTA was a major step for the free trade among the member states and is likely to contribute significantly to intra-regional trade, having a scope for enhanced trade between Pakistan and India. It is estimated that complete elimination of tariffs under SAFTA may increase intra-regional trade by 1.6 times over the existing level.<sup>83</sup> The trade between the SAARC countries within the region is about \$25 billion that makes 4.8 per cent of South Asia's overall trade with the world.

## **Trade Potential**

The trade potential for mutual trade between Pakistan and India is significantly high. According to Ishrat Hussain, a renowned economist of Pakistan, "India-Pakistan is a win-win situation," 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.<sup>84</sup> It is evident from the

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<sup>83</sup> Federal Bureau of Statistics, Government of Pakistan.

<sup>84</sup> Ishrat Hussain, "Prospects and Challenges for Increasing Pakistan-India Trade", Issue Brief, Atlantic Council, (November 2011), pp. 15-16.

economic advantage point out by economists that the bilateral trade is advantageous to both countries.

Out of these advantages, the major advantage for both Pakistan and India is the cheaper transportation costs due to shorter distances thus reducing the costs of trade. If the trade of \$1.5 billion carried out illegally is brought under the official trade it will increase the revenues of the state. If the process of trade liberalization continues, in the longer term there is potential for increased investment including joint ventures.

Compared with India, the advantages for Pakistan as a result of trade are greater than the larger India. Trade with India would result in the growth of Pakistan's economy, the growth which stands stalled now. There are two ways through which economic growth can take place: through major structural transformation or through trade. In case of Pakistan, the economic structure has remained unchanged for at least 40 years; the only way left is economic growth through regional trade and investment. Against this backdrop; India seems to be a measure trade partner, trading with it can result in Pakistan's economic growth. Pakistan's textile and food industries can find markets in northern India while India can meet its energy requirements through tapping Pakistan's huge reserves of coal, the world second largest reserves.

Both countries enjoy advantages in different items. India has an advantage in rice, maize and grains while Pakistan enjoys advantage in Basmati rice, cotton and fruits and these items easily find markets in India. Pakistan's agriculture has become more efficient in recent decade and is in a competitive position with Indian agricultural sector despite the latter's huge input.<sup>85</sup> In addition, there is a relation between the Indian success and Pakistan's benefit as Pakistan's

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<sup>85</sup> Ibid., pp. 25-26.



farmers would significantly benefit from the Indian success in raising yields per acre through improvements in seed, irrigation and mechanical technologies.

Such views that underscore the resultant mutual benefits of trade are held by most of the mainstream political spectrum. The mainstream political parties favour the enhancement of trade with India which they believe would bring enormous benefit to Pakistan and help it meet the worst energy crisis. It is also held by the mainstream political leadership that increased trade and regional trade integration can be a panacea to Pakistan's growing abject poverty. It is also complained that SAARC has the lowest level of trade and commerce of any economic zone not only less than European and American zones but also less than the zones in Africa and Middle East. So, it is argued that, both countries have to find ways for greater economic cooperation, without losing principal stances on Political realities and issues.<sup>86</sup>

### **Facilitating Economic Cooperation**

In order to reap the benefits of trade liberalization and economic cooperation, Pakistan and India need to introduce visa regime changes. It is understandable that without the movement of people there is no thinking of movement of goods. Both India and Pakistan have many tourist destinations and tourist trade can account for a huge amount of trade between the neighbouring countries. However, the current visa regime of the two countries imposes severe restrictions on trans-border travel, including long processing time; a single-entry limit; city specific authorization, with a three city limit; police reporting requirements; and the same entry and exit points.<sup>87</sup> In relation to visa regime changes, The Islamabad-New Delhi dialogue has provided

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<sup>86</sup> "Pakistan's Relations with India: Beyond Kashmir, International Crisis Group", Asia Report, No.224, (May 2012)

<sup>87</sup> Ibid., pp. 19-20.

some progress with both parties agreeing, in principle, to a more liberal visa regime for the business community. This principle understanding needs to be materialized so that the pace of trade should increase. Moreover, in the meantime the governments and business communities from both sides should form more contacts with the potential traders and investors, for instance, through organizing trade exhibitions that could provide an environment facilitating access, interaction and sharing of information and goods alike.

Softening of visa regime would ensure an easy cross-border movement that in turn would enable potential investors to gauge opportunities. This would also increase the Indian FDI in Pakistan and vice versa. Although Pakistan has already been allowing incoming Indian FDI, Indian businessmen have been showing hesitation in investing in Pakistan given the political instability and security related problems. A major part of Indian business community wants to invest in Pakistan on the one hand while they fear to come to Pakistan because of security fragility on the other hand. Many prospective investors in Pakistan distanced themselves from such a venture after the Mumbai terror attacks and similar terrorist activities in Pakistan after 9/11. So ultimately, the prospects of Indian investment in Pakistan depend upon the security and democratic transition in Pakistan that would ensure stability.

### **Prospects for Economic Integration**

It is a positive sign that both India and Pakistan have opened up their economies, relinquishing the old import-substitution policies favoring autarky, and adopted a policy of economic

integration with the world economy. The reforms carried out as a result have placed the two countries in a better position to follow preferential trade liberalization.<sup>88</sup>

Pakistan and India, along with other South Asian countries, signed SAFTA in January 2004 that came into force in January 2006. The main purpose of SAFTA was to reduce and subsequently eliminate tariff barriers, facilitate cross-border movement of goods, promote intra-regional fair competition, and create an effective and efficient framework for regional cooperation. However, the efficacy of the agreement is still impeded by the restrictive sensitive lists adopted by the member countries.

A recent study has showed that India is increasingly shortening its sensitive list under SAFTA. Out of five SAARC member countries covered in the study, Sri Lanka, Nepal and Bhutan have already signed bilateral trade agreements with India. Bangladesh has been given a LDC status and only 331 items are placed under the operational list applicable to it.<sup>89</sup> These leave Pakistan to be the only state with a non-LDC status and resultantly the sensitive list applicable to Pakistan contains the largest number of items, 868.

If implemented in their true essence and spirit, the regional trade agreements like SAFTA are destined to produce a positive effect on trade, growth, technological dissemination, and increased Foreign Direct Investment. Intra-regional trade will unchain innovative technology, lower domestic prices and ensure the market expansion. There are several fronts on which joint ventures can be successful under SAFTA, for instance, in pharmaceuticals, chemicals, petrochemicals, automobiles, agro processing, technology transfer among IT firms and joint gas

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<sup>88</sup> Zareen Naqvi, "Pakistan-India Trade Potential and Issues", (Unpublished Paper), 2008.

<sup>89</sup> Nisha Taneja and Saon Ray, Neetika Kaushal, Devjit Roy Chowdhury, "Enhancing Intra-SAARC Trade: Pruning India's Sensitive list Under SAFTA," ICRIER Working Paper 255, New Delhi, (April 2011).

pipelines. These joint ventures can only happen if the member countries foment harmonization under the aegis of SAFTA.

Different studies have shown different results about the prospects of regional trade in SAARC area under SAFTA. Empirical studies carried out on the subject have elicited mixed results given the smaller size of the member countries that are either landlocked or very small in size in comparison with a huge economy like India. Research studies based on computable general equilibrium model simulations suggest that the policy of unilateral liberalization would benefit the South Asian countries much more than under SAFTA, as in this case smaller countries would gain little or even lose.<sup>90</sup>

However, a different and opposite to the above conclusion is reached by A European Study Group report regarding trade in South Asia using the gravity model.<sup>91</sup> During the course of its analysis, this study showed that there is a significant trade-creation effect with the outside world under the South Asian Preferential Trade Agreement (SAPTA). The report does not find any evidence of the trade diversion effect with the rest of the world, and states that increased regional integration may bring substantial benefits to the SAARC region and the agreement will enhance intra-regional trade through the elimination of tariff barriers and non-tariff barriers among the member countries.

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<sup>90</sup> J.S. Bhandara, "How Desirable is the SAFTA? A Quantitative Economic Assessment", *The World Economy*, 2003.

<sup>91</sup> S.W. Hirantha, "From SAPTA to SAFTA: Gravity Analysis of South Asian Free Trade", European Study Group, 2004.

## **Future Scenario**

The study has concluded that there are huge prospects for economic cooperation between India and Pakistan and this cooperation would not only help these two nations but would also contribute significantly towards the regional peace and stability. There is also realization and strong urge in both countries to increase the trade and other economic links between India and Pakistan. However the political differences are causing the major hindrance in the enhanced economic relations. The complexity and nature of these political issues is such that the normalization of relations between India and Pakistan seems a huge task. The progress on the issues that are easily resolvable is also nominal. The major bone of contention between India and Pakistan; the issue of Kashmir will remain source of tension and its solution seems impossible. In such scenario the substantial breakthrough on economic cooperation between India and Pakistan seems impossible. Therefore in spite of great prospects for economic integration the volume of trade between India and Pakistan would remain low and no significant improvement is sighted in foresighted future. The sustained thaw of peaceful relations of both countries is prerequisite for any positive outcome related to enhance economic cooperation between India and Pakistan.

## **What needs to be done? / Recommendations and suggestions**

The study has recommended policy options for both countries that are imperative for the purpose of gradual increase towards the path of economic cooperation between India and Pakistan in the environment of hostility and mistrust. The first step towards a peaceful and economically developed region is that both countries need to indulge in negotiations to seek the permanent solution of all bilateral outstanding issues between the both countries. The major factor for

failure of negotiations has been the inability of both countries to sustain the dialogue process. During the last few decades it was observed that a single incident can disrupt the whole process of dialogue. Only a sustained peace process can guarantee any significant development in the solution of bilateral issues. Then the leadership of India and Pakistan needs to understand the significance of economic cooperation for the regional peace and stability. They need to prioritize the process of economic integration at bilateral as well as regional level. The initial steps on the behalf of the governments could include the softening of visa restrictions and providing the suitable environment for investment to the people from each other's country. In this regard the track II channel of diplomacy needs to be effectively utilized. Now is the time when the NGOs from countries, leading economists and civil society representatives need to play their respective role for bringing both countries towards the path of peace through encouraging and promoting the economic agenda that includes the close cooperation between India and Pakistan.

## **Conclusion**

The 21<sup>st</sup> century in international politics is considered to be the era of economic cooperation and integration among the regional states. The old rivals have become the partners due to their common goal of socio-economic development through the economic cooperation at regional as well as at bilateral level. Though the economic integration is being witnessed throughout the world but the South Asian region is still the least economically integrated region of the world. The region has huge potential of economic integration but the rivalry between India and Pakistan is the major hurdle in the process. The study has identified that economic cooperation between India and Pakistan would not only be beneficial for the social development in both states but it would also significantly contribute towards regional peace and stability. The benefits of economic cooperation would be equally great for both countries. For Pakistan, economic cooperation with India would help in recovering its hard hit economy by the energy crisis. For India, Pakistan could provide a link to its market in Central Asian states through Afghanistan. The economic cooperation would also be a blessing in disguise for the Afghan people as well. This development would not only decrease the chances of proxy war between India and Pakistan in Afghanistan but would also bring economic prosperity in the country as a result of economic stability in the region.

The enhanced economic cooperation would make the stakes high for both parties to indulge in hostile activities against each other. But the chances of close economic cooperation between India and Pakistan should not be expected in near future. There are multiple factors that have made the prospects for trade liberalization between India and Pakistan very slim. The political issues between India and Pakistan are very complex and these issues would remain the cause of

tension between the two neighboring nuclear armed countries. The study has identified the issue of Kashmir the major obstacle for normalization of relations between the both countries. The terrorism factor has added a new dimension into the hostile relationship of India and Pakistan. In the backdrop of all these issues of divergence and the resulted mistrust the close economic cooperation seems a difficult goal to achieve in foresighted future.



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