ANALYSIS

Thawing the insulation

The fate of India-Pakistan economic ties seems pegged to the fluctuating peace process between the two countries. But the normalisation of bilateral economic relations is inevitable, and such a profound development will have far-reaching and unforeseen implications.

by Haris Gazdar

There is plenty to be sceptical about the current ‘peace’ process between Pakistan and India. The immediate impulses behind this peace process are none too encouraging. In particular, the military-led government in Islamabad is under tremendous pressure from its US backers to adopt a cooperative posture vis-à-vis the giant eastern neighbour. The Pakistani military, unsurprisingly, is a corporate player with a history and culture of animosity towards India. Some peace-process optimists argue that it is for this very reason that the military is the most reliable deliverer of amity – weak civil leaders cannot make credible promises and survive.

The logic that hawks can be reliable peace-makers is widely used in international relations, but what of the fundamental political and economic interests of Pakistan’s military, which might actually lie in the perpetuation of the state of cold war in the Subcontinent? Any normalisation process would undermine the political legitimacy of the military as an entity, consequently giving rise to challenges to its claims on the country’s economic resources. These claims would not be limited to the public purse, though that is important. They would extend to the military’s vast and expanding corporate empire, spanning sectors such as manufacturing, finance, property development, freight, air travel and agriculture. Why should a corporate entity that is known to jealously guard its interests bring about its own studied demise?

The fact that the current peace process is largely choreographed by the United States also, paradoxically, does not bode too well. Far from providing assurance, the deep and detailed involvement of the superpower highlights the possibility that domestic political constituencies for peace are not as well prepared as they might appear. The tectonic shift in Southasia, of course, is the investment being made by the US and India for a close, long-term relationship, with security at its core. Pakistan’s relationship with India must ultimately adjust to the requirements of the developing Indo-US relationship on the one hand, and Pakistan’s own close security relationship with the US on the other.

Herein, interestingly, is where the American link is a source of weakness. The primacy of the security agenda in all of these mutual relationships – in the place of, say, an economic development agenda, or even a ‘security-through-development’ agenda – means that the parties are free to play drawn-out games in other spheres, as long as the core concern of the key protagonist is respected. The two neighbours have a proven historical ability of playing such drawn-out games. Pakistan, the smaller party, probably outclasses India, having played the game as a state-survival strategy for much of its history.

Pakistan's military establishment, the country's most powerful political interest group, continues to regard India as an existential threat. It has mastered the art of walking the tightrope between America's long-term (security engagement with India), and its short- to medium-term interest in the 'war against terrorism'. The peace dance can be performed to a slow beat while keeping the powder dry. Things can and do change – so the reasoning goes. The US might leave Pakistan to its own devices, its objectives might be reined in, there might be a regime collapse in Afghanistan, or a regime change in Washington DC. American willingness to underwrite the Pakistani military cushions the latter from economic imperatives and political constituencies for peace-making.

It's the economics

Scepticism about the current peace process does not mean that economic normalisation is not inevitable. There are far stronger gravitational forces towards normalisation than even the might of the United States. These forces have to do with the historical moment we inhabit, in which the economic insulation of the India-Pakistan boundary becomes more anomalous by the day. There are few frontiers left in the world today that are as off-limits as this boundary line. The examples that do spring to mind – North and South Korea, Israel and some of its neighbours (Syria and Lebanon) – simply confirm the mid-20th century vintage.

The Pakistan-India frontier is bound to be breached, for the economic imperatives are just too overwhelming. The rising volume of legal and documented trade between the two countries, as well as estimates of illegal and undocumented trade, attest to this inevitability. The two economies are not only geographical neighbours, they operate at comparable levels of technology, and share similar levels of purchasing power, tastes and preferences. They are natural candidates for market integration – something that is understood by economic players in both countries, and by foreign multinationals.

Both India and Pakistan are developing their economies in order to compete in global markets. They operate in highly competitive sectors where market share depends on small differences in margin. The insulation of the two economies puts strains, at times unbearable ones, on domestic consumers and manufacturers alike. Ad hoc crossborder trades – such as those in food commodity in order to avert price crises – have become common. Pakistani manufacturers have become strong proponents of the import of cheaper Indian capital goods and raw materials. Major future investments in the energy sector, and hence in all other sectors, hinge on political cooperation between the two countries. Even if the Iran-Pakistan-India gas pipeline is blocked by the US, an alternative such as the Turkmenistan-Afghanistan-Pakistan-India gasline is also viable only if the Pakistan-India component remains intact.

A continued posture of insulation will also become increasingly difficult to sustain in terms of regulation. There is political consensus in both countries towards greater trade liberalisation. Economic players already bypass regulation using a variety of means such as third-country routing and crossborder smuggling. The question is not if, but when economic relations will be normalised. The fact that the current peace process is driven largely by American security imperatives might delay economic integration, but it will not stop it.

Opening up

'Normal' economic relations would obviously mean relatively open trade regimes between countries. The governments have signalled their commitment to this outcome by entering the South Asia Free Trade Area (SAFTA) agreement, which came into force at the beginning of this year. But in today's world of economic globalisation, normal relations mean much more than the lifting of trade barriers.

Normalisation implies, ultimately, the development of intra-industry trade across national boundaries, harmonisation of economic activities, economic governance, and joint and crossborder investment. The contemporary trajectory of normalisation seeks a seamless transition from trade liberalisation to all-around market integration and institutional coordination. The SAFTA agreement acknowledges this reality when it makes reference, under its Article 8, to "macro-economic consultations", "removal of barriers to intra-SAARC investment", and "rules for fair competition".

At the time of Partition, India and Pakistan had initiated the processes of mutual economic dislocation and inward-looking national economic development. Increasing barriers to economic interaction between the two countries led to a virtual state of insulation in the 1960s, at a time when the world was divided into self-contained economic blocs. The institutional architecture of the world economy at that time was not inconsistent with the closed borders of Southasia.

Inter-country economic opening in that era could be controlled and limited to selected sectors and actors. Across the ideological divide, it was the norm for the state to mediate, monitor, regulate and control economic interactions between their respective citizens and corporations. Countries that allowed even such limited interactions were considered to be relatively open economies. In today's world, such a controlled opening will be neither credible nor feasible.

Normalisation of economic relations, once started, cannot be monitored, let alone regulated to any effective degree by the states. Multi-dimensional market relations will proliferate, and a wide range of citizens and corporate entities from across borders will make joint economic decisions on a regular basis. One-off transactions will give way to durable and profitable economic relationships between numerous and diverse economic agents across borders. How will the economies and societies respond, and what will be the issues that are likely to emerge?

Institutional evolution

At least in Pakistan, there are competent studies of the impact of trade opening with India on various sectors. These date back to at least ten years ago when the Ministry of Commerce became interested in the issue. More recently, the same ministry, as well as other government and private organisations, have been engaged with the issue. The main findings, which have been widely disseminated and discussed in business circles, are that the Pakistani economy will be a net beneficiary, the position of certain sectors notwithstanding.

Meanwhile, in Pakistan, those in strategic studies are concerned by the relative pace of economic development in India and Pakistan, and what this implies for the trajectory of conflict management. Here the dominant conclusion is that the balance of power will continue to shift towards India (partly due to its higher rates of economic growth), and that India, being the 'status quo' party in all of the key disputes, will gain from drawing things out, whereas a quick settlement will allow Pakistan to achieve relatively less unfavourable terms.

But neither technical economic impact analyses nor strategic studies can anticipate the dynamic behaviour of individuals or groups, or predict institutional outcomes in economies and societies. In lieu of systematic inter-disciplinary analysis, the crystal ball must rely on a reading of post-Partition institutional development. This admittedly speculative exercise might yield some useful lines of future enquiry, at the very least. We do not know when exactly the process of economic normalisation will accelerate – the ambitions of SAFTA notwithstanding – but we can begin to give due weight to what we do know about how things have fared in the two countries during the period of insulation.

Despite the apparent similarities in economic management – fiscal conservatism, use of planning, inward-looking policies followed by liberalisation, mixed-economy regimes – India and Pakistan have ended up with very divergent outcomes. India used its period of inward-orientation to integrate her national economy. The institutions of the modern state that were more developed in India to begin with, became stronger. The process of the formalisation proceeded apace, and traditional economic networks, such as those based on caste and kinship, were built upon to create world-leading corporate entities. Regional interests ultimately found expression in Centre-state politics, and the creation of a national market was mediated (conservative economists might say slowed down) through political stakes created at the state level.

In Pakistan, the institutions of the modern state lost over time in their ability to transform traditional social relations. There was a steady informalisation of the economy that corresponded with the incapacity of modern systems for contract enforcement, let alone regulation. The writ of the state actually weakened, which enabled individuals and groups to engage in relatively unfettered economic activity within the country and abroad. The relatively large incidence of international migration – facilitated by informal social networks rather than formal systems – further eroded the 'control' the state might have exercised over the process of economic development. Informal networks not only persisted but also became more powerful, as formal political channels of interest-representation were frequently disrupted.

***Bhai-bhai* economy**

What will closer economic interaction – or even market integration – imply for these two economies with divergent paths of institutional development? It is fashionable in some quarters to hold forth that India's strength will ensure that Pakistan becomes an economic appendage. This is merely an acknowledgement of the difference in the size of the two economies. Going beyond the issue of size, some salient patterns are likely to emerge.

Successful Indian players will end up having to rely on the informal networks of their Pakistani counterparts in order to make a success of their ventures in the country – be they related to trade, investment or joint production. The relative weakness of the institutions of the modern state in Pakistan will ensure that only those who are linked with existing social networks will make progress in the first instance. The Indian economy, on the other hand, is likely to be more open, in an anonymous market sense, to Pakistani players. Individuals and smaller corporate entities from Pakistan are likely to be more successful in their access to Indian markets than are their Indian counterparts. On the Indian side, major companies will lead the way, at the expense of individuals and small businesses.

Those Pakistani individuals and groups with existing connections and linkages across borders will benefit greatly, often at the expense of those who do not have these connections. And those that have connections of different types will prosper in different ways and develop divergent interests vis-à-vis their Indian counterparts. Economic players in the central Punjab hub around Lahore, for example, have had the opportunity over the last 20 years or so of developing links with their counterparts in the Indian states of Punjab, Haryana and Delhi. These connections have received official patronage at various times. In Karachi, on the other hand, there are trading and entrepreneurial groups embedded in entire kinship communities with close crossborder ties. These groups, including Muslim Gujaratis, Kachhis and Memons, as well as segments of the Urdu and Sindhi-speaking communities, have continuing kinship and business links in India.

Closer integration with India may open up inter-regional linkages within and across the provinces of Pakistan. Market integration or even market opening will not happen in abstract anonymous terms, after all. It will occur through real interactions between real economic players large and small, who in the Pakistani context have social, ethnic, kinship and regional identities. There may be conflicts between those who are direct and those who are second-round beneficiaries of Indian connections. Importantly, there might also be a divergence of interests among those with Indian connections – for example, between Lahore and Karachi – and the possibility of internal market dislocation alongside external market integration.

These patterns will give rise to new opportunities as well as new sources of tension and conflict. Political entities on all sides will need to deal with issues with tact and sensitivity. The success of Indian companies in Pakistan and Pakistani individuals in India might give rise to mutual resentment. Tensions within Pakistan between regions and ethnic communities might also lead to destabilisation, particularly considering the relatively weak forums, when compared to India, for representing regional interests.

These potential potholes do not imply that economic integration is harmful, or indeed, that it can be stopped. In general terms, the normalisation of economic relations between India and Pakistan will be good for both the economies, and for Southasia as well. Moreover, attempts at delaying or stopping this normalisation will become costlier with time, and will divert attention away from the more urgent task of political and institutional preparation necessary for orderly economic integration.

Much of the running in terms of institutional development will have to be done by Pakistan. It will have to empower existing institutions of political representation (Parliament, assemblies, political parties, election commissions) at the national and provincial levels, so that potential disputes can be handled within the political process. Pakistan will also need to strengthen formal state structures and use these for the modernisation of social and economic relations. Systems of property rights, trust, arbitration and dispute resolution will need to move away from traditional social structures and towards modern citizenship.

These 'nation-building' transitions and others that were consonant with the post-colonial moment have few active supporters in the era of globalisation. India, however, will need to provide Pakistan with the space and time it needs to make these necessary transitions. It will require a robust, effective and unified modern state as its partner in

Pakistan if the process of economic integration is to be managed successfully. Resisting the temptation to do anything else will test India's political foresight and fortitude to the limit.

PULLQUOTES

Pakistan's relationship with India must ultimately adjust to the requirements of the developing Indo-US relationship on the one hand, and Pakistan's own close security relationship with the US on the other.

There are far stronger gravitational forces towards normalisation than even the might of the United States.

Individuals and smaller corporate entities from Pakistan are likely to be more successful in their access to Indian markets than are their Indian counterparts.

These patterns will give rise to new opportunities as well as new sources of tension and conflict. The success of Indian companies in Pakistan and Pakistani individuals in India might give rise to mutual resentment.