

## Trade Trumps War

*Economic growth is driving the most significant moves in decades toward peaceful stability between India and Pakistan. Here's how the prospect of expanded business links is doing what nuclear threats and bluster never could*

By Jay Solomon/ISLAMABAD

ONE TRIUMPH FOLLOWED another during a three-day summit in Pakistan that might someday be seen as a watershed in the history of India-Pakistan relations. As the annual South Asian Association for Regional Cooperation (Saarc) summit in Islamabad wound down on January 6, the two countries announced the start of bilateral talks next month in which all topics, including the disputed region of Kashmir, will be open for discussion. Indian Foreign Minister Yashwant Sinha was gleeful: "It is a victory for common sense. It is a victory for moderation. It is a victory for statesmanship. It is a victory, particularly, for the poor people of South Asia."

Sinha might have added that it was a victory for business. As much as anything, the peace offensive launched by India's Prime Minister Atal Behari Vajpayee and Pakistan's President Pervez Musharraf seeks to recast the New Delhi-Islamabad relationship on an economic foundation, which may prove to be more enduring than past fretful concerns about security.

India, in particular, now seeking to match China as Asia's fastest-growing economy, has aggressively sought to smooth relations with Pakistan. In fact, this issue of reduced tensions between India and Pakistan — and among all countries of the region — is central to the theme of economic integration that dominated the annual Saarc summit. Fear of conflict has long intimidated potential foreign investors and crimped trade among the region's 1.5 billion people.

Even before the dramatic announcement of February talks, business people in both India and Pakistan seemed giddy. They were especially enthused by the agreement among Saarc's seven members to begin reducing trade tariffs starting in 2006 and to dismantle non-tariff trade barriers.

"This is definitely a positive development," says P.K. Mukherjee, a director at Sesa Goa, a major Indian iron-and-steel firm that began exporting to a Pakistani customer in 2003. Pakistani businessman Jamil Nehboob Magoom, who is vice-president of a business association in the region, was equally enthusiastic: "This is a big step forward. We get a huge market for our products."

Justifying such optimism won't be easy. Peace talks between India and Pakistan are expected to be a drawn-out affair, with both sides being pressed to give ground in Kashmir, where sovereignty has long been in dispute. Regional integration, too, frightens small countries wary of being swamped by Indian products once trade-protecting tariffs are reduced. Vajpayee summed up the crux of the challenge in remarks during the Saarc opening ceremony on January 4: "We must make the bold transition from mistrust to trust, from discord to concord, and from tension to peace."

Islamabad hardly seemed a likely setting for Subcontinental bonhomie. The city was virtually locked down after two assassination attempts against Musharraf in December. Roughly 10,000 police and commandos patrolled the capital's deserted streets. And the shops that surround the Jinnah Convention Centre were shuttered as armoured limousines ferried leaders to and from the summit.

But the growing goodwill between India and Pakistan broke through the unease almost from the moment Indian officials arrived. Vajpayee surprised a Pakistani television audience by referring to Gen. Musharraf — a man widely viewed by Indians as the architect of a violent 1999 flare-up between the countries known as "The Kargil War" — as someone "we think we can have talks with." Pakistani Prime Minister Zafarullah Khan Jamali responded by praising the 79-year-old Vajpayee as a "poet" and a "visionary."

This diplomatic U-turn, following five years of often-bitter acrimony, is partly being nourished by external forces, South Asian diplomats say. The United States and China, in particular, have pressured both countries to move ahead with a dialogue after war nearly broke in mid-2002 following an attack by Muslim militants on New Delhi's parliament building. Musharraf is also seen as eager to score points with the international community, which is increasingly critical of Pakistan's alleged role in trading nuclear technology to North Korea, Iran and Libya.

But, as much as diplomacy, economics is driving the current peace process, say Indian and Pakistani officials. The two countries voice confidence that they can gain ground economically on their East Asian rivals if they install effective security and investment regimes.

"The vision and courage demonstrated recently by the leaders of India and Pakistan in their efforts to resolve bilateral issues have infused this summit ... with a new sense of purpose and vigour," Sri Lanka President Chandrika Kumaratunga said on January 4. Sri Lanka stands to benefit hugely from greater stability, given that it signed free-trade agreements with India and Pakistan last year. When the final figures are in for 2003, Colombo expects Sri Lanka's economy will have grown 5.5%.

New Delhi has announced sizzling growth for the July-September quarter, raising the prospect that India's economy could grow by 8% in the fiscal year that ends on March 31. And Pakistan expects the final figure for 2003's growth to be nearly 6%, thanks in no small part to Islamabad's alliance with Washington in its war on terror.

The agreement to lower tariffs and eliminate non-tariff barriers was part of a landmark free-trade agreement reached during the summit. Under the terms of the deal, Saarc members are required to reduce their intra-regional tariffs to 5% or less over the next decade while eliminating

informal trade barriers. Saarc also committed itself to developing a regional development bank, a common currency and, ultimately, economic union.

Regional diplomats warned that implementing the South Asia Free-Trade Area by January 1, 2006, would be a daunting task. Countries are already drafting lists of products they'll seek to shelter from tariff cuts. And then there is the fear among smaller South Asian countries of being swamped by the big guys.

"Nepal's markets are already completely controlled by Indian products," says Mukunda Kattel, a member of a Kathmandu-based agency focusing on rural development. "The trade agreement runs the risk of only benefiting the Indians." To address this, Saarc's larger economies may establish guidelines to provide compensation to poorer countries that might initially suffer. Vajpayee pledged to set up a regional poverty-alleviation fund, committing New Delhi to initially provide \$100 million.

Officially, bilateral trade between India and Pakistan registered just \$200 million last year, but many analysts put the real figure at around \$2 billion if India-Pakistan trade routed through third countries is counted. Pakistani and Indian officials say the higher number could double or more in the short term.

Indian businessmen say they are interested in investing in Pakistani coal and gas interests. Magoom, the Pakistani vice-president of a South Asian business association, says that he thinks that Indian pharmaceuticals and engineering products will do especially well in Pakistan. As for Pakistan, Magoom thinks textiles, herbal products and salt will find markets in India. In March, he says, Pakistan is planning an exhibition of its wares in New Delhi — something that would have been unthinkable a year ago.

Tariq Sayeed, a former president of the Pakistan Chamber of Commerce, says he's been pushing his government for more than a decade to forge a free-trade agreement with India. Local companies are penalized by huge transport costs because of India-Pakistan tensions, he said. They also face prohibitively high input costs for their exports because of India's trade barriers. "This move for free trade was long overdue," says Sayeed, speaking from Karachi. "Without this, we run the risk of falling behind the rest of the world."

Pakistani government officials also say that, despite the recent attacks on Musharraf's life, brightening economic prospects have allowed him to push forward with economic reform. Last month, Islamabad completed its largest privatization ever, selling a controlling stake in Habib Bank to the investment arm of the Aga Khan Foundation for \$400 million. Pakistan's privatization minister, Hafeez Shaikh, told the REVIEW that the prospects for his programme are strong as Islamabad prepares to divest stakes in state-owned energy, insurance and utilities companies. "The overall law-and-order situation is improving," Hafeez says. "People who are doing business here say they don't see risk as overwhelming anymore."

Are they forgetting Kashmir? This is one issue that could still stop diplomatic momentum. Pakistani officials stressed this week that no normalization of relations with India is possible until Kashmir is addressed. And many Indian diplomats say they are sceptical that Musharraf can really give ground on Kashmir, given that his own political position in Pakistan is under attack. It is no less a problem for Vajpayee, though his aides say that he is committed to normalizing ties with Pakistan as a way to solidify his legacy. When announcing peace overtures towards Pakistani last April, the Indian leader said it was his final attempt at peace.

Indian officials say that Vajpayee's peace overtures fit into his longer-term vision — perhaps copying the Taiwan strategy employed by China — of sidelining territorial disputes to focus on the economy. India and China made historic steps last year toward resolving joint claims on their shared Himalayan border. One result has been a surge in India-China trade. Indeed, India's Commerce Ministry says trade between the two countries could grow to \$10 billion during the next fiscal year from just over \$2 billion five years ago.

New Delhi hopes that a similar formula can work with Pakistan, according to officials close to Vajpayee. Already this year, India has championed a sharp increase in cultural and sporting exchanges as a means to promote détente between the two countries. On January 4, Vajpayee said growing trade could help solidify this improving relationship. "The development of greater economic stakes in each other would naturally result in a greater sensitivity to the concerns of each other," he said.

### *More Good News for Investors*

International investors in India welcomed news of peace talks between Islamabad and New Delhi, saying the warming of relations between the two neighbours reinforces their already bullish outlook for 2004. **"The level of tension has never been this low," says Jon Thorn, manager of the \$65 million India Capital Fund. "With that portion of the geopolitical risk taken out of the picture, India must become a more attractive investment."**

International investor interest in India is already high: The Mumbai stock market took off last year, returning 80% in dollar terms. With economic growth projected to approach China's rates over the coming years, ad deregulation and privatization accelerating, many institutional investors are now looking at allocating assets to India for the first time.

"Globally there is a lot of excess liquidity trying to find a home," says Tathagata Ghose, an economist at investment bank Dresdner Klenwort Wasserstein in London. With India set to benefit from global trends towards outsourcing, some of that spare cash is likely to find a place in the Mumbai market. "Rising foreign investment is almost certain over the next year or so in India," he predicts.

### GIVING PEACE A CHANCE

- India and Pakistan said that they will hold talks next month
- Business interests are driving dramatically improved relations
- Kashmir remains the biggest obstacle