

# INDIA AND ITS NEIGHBOURS: DO ECONOMIC INTERESTS HAVE THE POTENTIAL TO BUILD PEACE?

*Charu Lata Hogg*

A Chatham House Report  
in association with  
International Alert

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## EXECUTIVE SUMMARY

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Until a decade ago, India was regarded largely as a poor developing country with low visibility on the global political and economic front. A multitude of factors, most prominently its emerging global economic strength, have led India not only to redefine its self-image but also to adopt a new political role both internationally and within its immediate neighbourhood.

The aim of this report is to conduct a preliminary investigation into the linkages between India's growing economic and political clout and its correlation, if any, to peace-building in South Asia, with particular emphasis on conflicts in Sri Lanka and Nepal. The report starts from the premise that India occupies a special position in the region, economically and politically. Owing to this unique position, India has a particular potential vocation to become the driving force for greater regional peace and prosperity. The analysis in this report supports the argument, recognized by many Indian policy-makers, that India's long-term prosperity hinges to some degree on a conflict-free neighbourhood; that an economically integrated region is in India's overall security interests.

The report examines in detail India's spectacular economic performance, its strengthening position in the global order and its evolving special relationship with the United States. It lays down the larger landscape within which the 'new India' views the world and the region and examines India's broader foreign policy concerns as its increasing financial muscle triggers a shift from *moralpolitik* to *realpolitik*. This shift is most visible in the change from its traditional path of non-alignment to a strategic alliance with the US. India's complex relationship with China shows how India is seeking economic complementarities with its giant Asian neighbour, while at the same time consciously competing with it on procuring energy and on geo-strategic and political levels.

India's policies towards its neighbours in the current context are best understood within the framework of its overall foreign policy concerns. India's burgeoning global presence and its larger economic interests are bringing a subtle reconsideration of its policies towards its neighbours. With economic integration and energy self-sufficiency emerging as the two most important pillars of its foreign policy, India has made strong economic overtures in the region. It has a successful trade agreement with Sri Lanka, has made Bangladesh and Pakistan a similar offer, has entered into various multilateral trade agreements and is keen to be involved in Nepal's economic recovery.

It is argued that India's attempts at development cooperation in the neighbourhood and encouraging bilateral trade are driven, not just by economic concerns, but by a sharp realization that its political capital in the neighbourhood is fast dwindling. Its relationship with all its neighbours, including Sri Lanka and Nepal, is complicated, and, especially in the case of Sri Lanka, India's reluctance to play a more politically active role in resolving the twenty-year conflict is unlikely to diminish.

Despite some successes, India's economic engagement with its neighbours continues to be crippled by deep-rooted political tensions. Current research suggests an absence of any trade–conflict causality in South Asia. In other words, trade agreements, whether bilateral or regional, do not seem to have had any positive influence yet in reducing conflict in South Asia. However, the two cases under study – Sri Lanka and Nepal – have varying political and economic complexities and offer different potentials for peace-building.

The potential for India to achieve peace-building in Nepal by pursuing an equitable economic relationship is far clearer than India's current economic relationship with Sri Lanka. This could be because in the case of Nepal, the convergence between India's security, geo-political and economic interests is much clearer and more tangible than in the case of Sri Lanka. Further, past Indian involvement in Sri Lanka continues to cast a shadow on any active involvement by Indian businesses in peace-building within the country now. To a certain degree Indian policy-makers and the private sector alike, while encouraging and intensifying economic engagement with Sri Lanka, deliberately choose to separate the political from the economic processes and seem unwilling to consider any correlation between the two.

Despite the complications and past experience, peace-building within Sri Lanka and Nepal remains a concern for India. Given the complex and often contentious histories of the Indian state's relations with both its neighbours, the report raises for future research the idea of exploring the potential of business communities as an important constituency for peace-building. This is suggested because on a policy level, Indian industry is convinced of the need to economically engage with and support neighbouring businesses as an essential prerequisite for sustained regional development. In principle, the Indian government also appears keen to allow Indian industry to take the lead in shaping the contours of an economic relationship with Sri Lanka and Nepal. However, what appears to be absent at present is the political will to establish such a framework if it comes at a cost, albeit short-term, to Indian industry.

The lack of any correlation between the political and economic trajectories in the case of Sri Lanka, or of any positive fall-out so far on the conflict there from India's intensive trade relationship, may be attributable to the profile of Indian investors. Most Indian investments in Sri Lanka are large businesses that have the capacity to bear some conflict costs and move their businesses to other destinations should the costs become too heavy to bear. As the Sri Lankan Free Trade Agreement expands to include investments and services, along with trade in goods from 2008, an increasing number of smaller, regional players from south India could become the vital force linking economic and political policy.

The report aims to generate ideas for discussion and research and its findings should not be regarded as definitive. It should be regarded, rather, as a first step towards exploring the possibilities of using economic interests as a positive lever for peace-building.

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## ABOUT THE AUTHOR

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**Charu Lata Hogg** is a graduate of Hindu College, University of Delhi and the London School of Economics and Political Science. She worked as an international journalist in India and Sri Lanka for over 12 years, writing for *India Today*, *The Times of India*, the *Far Eastern Economic Review*, the BBC, the *South China Morning Post*, *Khaleej Times* and numerous other publications. Following this she worked as a consultant with the Coalition to Stop the Use of Child Soldiers and as freelance South Asia analyst for *Business Monitor International* and *Jane's Sentinel*. As Associate Fellow in the Asia Programme at Chatham House, she has briefed governments, non-governmental organizations, corporations and the media on a range of issues in South Asia covering political, economic and security trends. She is currently a researcher with Human Rights Watch and covers developments in India, Sri Lanka, Bangladesh and Nepal.

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This report arises out of a range of interviews conducted in New Delhi, Kathmandu and Colombo in November, 2006. Some of these conversations were conducted under the Chatham House Rule. For this reason, the opinions expressed and often directly quoted in the text, which are essentially derived from the interviews, are not specifically referenced. The analysis in this report is based on interviews with various Indian officials and academics who maintain that India's long-term growth and prosperity rest to a large degree on a conflict-free, economically close-knit neighbourhood.

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Responsibility for the content remains with the author.

*Charu Lata Hogg*





# 1 THE RISE OF INDIA

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## Emerging economic powerhouse

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India's dramatic emergence as a global power on the back of its economic growth is a phenomenon that many inside India are trying to come to terms with. In the first quarter of 2007, India's economy grew 9.2% – its fastest growth rate in 18 years, driven largely by services and manufacturing. For three fiscal years, expansion in Asia's fourth-largest economy has averaged 8.3%. At present it is projected to achieve a 10% rise annually between 2007 and 2009.<sup>1</sup> On this basis, India will have reached the European Union's gross domestic product (GDP) in purchasing power parity terms by no later than 2012 and will have clearly overtaken it by 2015.<sup>2</sup> World Bank data show that at the end of 2005 only nine economies had a GDP of more than US\$1 trillion; Brazil, South Korea and India were the next closest, with GDPs of almost US\$800 billion.

Growth in the \$854 billion economy is being spurred by a variety of factors, including higher savings rate, spending on roads, ports and other infrastructure and more foreign direct investment (FDI), according to global investment firm Morgan Stanley.<sup>3</sup> India's savings rate was 32.4% of GDP in the year ended 31 March 2007, higher than the average 25% of GDP between 1990 and 2004. Morgan Stanley's Chief Global Economist Stephen Roach observed: 'The takeoff phase of economic development has long been associated with saving and investment rates in excess of 30% of GDP. India is now on the move and could well be one of the world's most exceptional economic development stories over the next three to five years.'<sup>4</sup>

India's Deputy Minister for Commerce, Jairam Ramesh, says there is a new-found respect for Indians in the global arena. Indian confidence is rising and indicates a renaissance, not only in business. Since 2004, India's surging foreign-exchange reserves have enabled it to write off the debts of heavily indebted poor countries (HIPC) in Africa. The debt relief packages have been clearly beneficial to recipients and were intended to encourage other creditors to follow suit. At the same time, the relief was meant to demonstrate India's key leadership role in the developing world.

Yet several obstacles remain. Currently, India's trade amounts to only 29% of its GDP, as opposed to 57% for China. While India's FDI regime has been substantially liberalized in recent years, important sectors such as retailing remain restricted. Further, the current red-hot pace of growth is straining infrastructure and leading to a squeeze on capacity, which is fuelling inflation, now at a two-year high above 6%.

But the biggest challenge to India's economic growth and dominance remains the reality of the 'other' India: over 300 million Indians still live in abject poverty, and another 300 million hover precariously above the poverty line.<sup>5</sup> Poverty is most stark among rural constituents, in districts dependent on rain-fed agriculture, with poor connectivity, and among members of traditionally excluded groups. For several Indian intellectuals, 'while the growth graphs may be right, there are still two Indian economies, the fast-growing globalized sector and the rest, rural, retarded and ridden with poverty'. Interestingly, in its relationship with the rest of its neighbourhood, India seeks not to see the commonalities of shared poverty and socio-economic marginalization but instead defines the relationship from the perspective of a bigger, more prosperous neighbour.

Yet another road-block to India's growth could emerge in the form of HIV/AIDS. While less than one per cent of the adult population is currently estimated to be infected, the numbers will soon be greater than any other country in the world because of India's large, fluid population.

India's ability to become a successful exponent of the so-called Asian century will, it is said, 'inherently depend' on how it learns to marry its growth with social justice. Its position within the region and relationships with its immediate neighbours, for instance, will depend to some degree on how it manages to disentangle itself from its own internal issues of social unrest arising from exclusion and uneven development.

Undoubtedly, India's growth will be sustained only if it is inclusive and the gross inadequacies of infrastructure are addressed. This requires heavy investment – India will need to lift its spending on infrastructure from 6% to 9% of its current GDP – and political will. Ultimately, however, in comparison to Western economies which have an ageing demographic, India's young population will play an important role in determining its position globally.<sup>6</sup>

This relatively recent economic growth brought in its wake an acute realization of India's global position. The economic growth has validated what Indians had believed all along – that they are one of the key pillars of Asian civilization, that their moral power derives from India's status as the world's biggest democracy which has dealt with contemporary issues of 'secular freedom' for centuries, that it is India's 'inherent cultural and social capital' which will become the primary force in Asia and the rest of the world. This growing national confidence, emanating largely from economic growth, gave India the force needed to redefine its external strategy.<sup>7</sup>

Since it first tested its nuclear capability in 1998, provoking international wrath and condemnation, India entered a new era in its foreign policy. It made a decisive break with its tradition of *moralpolitik*, based on the non-alignment doctrine, and sought quite overtly the status of a great power. On its new-found global platform, India is proclaiming its new strategic significance by increasingly favouring 'hard power' geopolitics, instead of pursuing 'woolly notions of promoting democracy and human rights'.<sup>8</sup>

This view, that 'might' carries its own moral momentum, has found increasing numbers of takers in the new India of growing computer software-based operations and call centres. For a large number of Indians, the country was taken seriously only after it became a nuclear power – the world's largest democracy *arrived* on the global platform only after it entered into the 'Indo-US agreement on civil nuclear cooperation'.

Despite its status as an emergent power in Asia, India is not involved in the process of finding solutions to any of the serious conflicts in the continent. In fact, apart from its timely intervention during the December 2005 Asian tsunami, India has seldom been a front-runner on humanitarian or human security issues. Such messiahship does not appeal to India, which claims not to export ideas of democracy and good governance as part of its foreign policy.<sup>9</sup> This report will explore in more detail the impact of this inherent contradiction in India's foreign policy on its peace-building potential in the region.

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## Indo-US relations: entering a special relationship?

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The visit of US President George W. Bush to New Delhi on 2 March 2006 changed the way India was perceived in the international order and became symbolic of the special relationship between the two countries. The strategic bilateral civilian nuclear cooperation agreement concluded during that visit marked the fruition of a process initiated with President Bill Clinton's visit to India in 2001 and continued at the summit in Washington in 2005. Through the deal, India stands to gain access to US civilian nuclear technology in return for laying out 65% of its nuclear power production under international supervision and separating its nuclear facilities into civilian and military. While energy experts in India say that the deal would result in satisfying only 7% of the country's energy requirements when operational, its symbolism in the geo-political arena was unrivalled.

Through the agreement, New Delhi has managed to partially shake off its pariah status over its nuclear weapons capabilities in the global order and has emerged as the 'new Asian partner' of the United States. For the US, nuclear cooperation with India forms the bedrock of a wider set of strategic interactions aimed at harnessing Indian strategic capabilities. A foreign editor of a leading Indian newspaper believes that as the process of Asian integration deepens, the US will hope India will reprise in Asia the role Britain plays in Europe of being in and out at the same time. The US needs India as an Asian power to influence the design of the emerging Asian strategic architecture in such a way that vital US interests are not affected.

Though many intellectuals still claim that 'India maintains its historical commitment to non-alignment' and that 'there is wariness in defining ourselves as too overt supporters of US policy (particularly in the Middle East)', there is little doubt that the overriding priority of Indian foreign policy is establishing a 'special relationship with the United States', which goes well beyond the realm of nuclear cooperation. India's own internal politics with active and vociferous coalition partners and its own sense of where its national interest lies will undoubtedly cause some friction in the long run. Differences became apparent in 2003 when India refused to send troops to Iraq. Similarly, relations were strained when India decided to engage economically with Burma and when India insisted, after the Security Council censured Iran over its uranium procurement in 2005, that the Iranians had the right to pursue their 'nuclear programme for peaceful civilian use'.

Strategic gains aside, getting closer to the United States has brought economic dividends. Signing the nuclear agreement in the White House in December 2006, President Bush remarked, 'India's economy has more than doubled its size since 1991 and it is one of the fastest-growing markets for American exports.' The US is already India's leading commercial partner and its principal customer for goods and services (more than 17% of the total in 2005). US investments into India were \$3.1 billion over the period 1991–2003 (accounting for 16% of the total). More than 1,000 US firms are now based in India. In the high-technology sector, Microsoft is currently the most important foreign investor, followed by Oracle and General Electric Company (GEC).

Whether India's alliance with the US brings the kind of strategic congruence India had hoped for remains to be seen; as does the impact of this liaison on bilateral relationships with the Islamic world. Within India, the 'new framework' found many critics in civil society and the parties of the left. The latter are politically significant as it is on their parliamentary support that the present Congress (I)-led Manmohan Singh government relies. While some sectors within India opposed what they perceived as a subordinate patron–client relationship with the US, others felt that the shift towards the US as the 'first' pillar of India's foreign policy would prove costly in the long run.

The military dimension of the relationship, reflected in a far-reaching but controversial agreement called the 'New Framework for the U.S.–India Defense Relationship' signed by the defence ministers of both countries on 28 June 2005, is noted as particularly troublesome. This agreement commits both countries to collaborative 'multinational operations' and to strengthening their military capabilities 'to promote security' and 'combat proliferation' of weapons of mass destruction (WMDs). The two countries have also committed to a 'defence strategy' dialogue and intelligence exchanges, pledging to 'assist in building worldwide capacity to conduct successful peacekeeping operations, with a focus on enabling other countries to field trained/capable forces for these'. In private, Indian officials acknowledge that US policies in the Palestinian territories and Lebanon, Iraq, Iran and Afghanistan have an impact on India's relationships with its immediate neighbours Bangladesh and Pakistan.

The wars in Afghanistan and Iraq have particularly hardened Muslim sentiment in Bangladesh, which has seen a proliferation of militant Islamic groups in recent years. Indian authorities allege that these groups maintain linkages with insurgent groups in northeast India and that increased Islamic radicalization in Bangladesh following the 'war on terror' has spilled across borders.<sup>10</sup> In response, India's construction of a 4,000-kilometre fence between the two countries has further strained the bilateral relationship.<sup>11</sup> Despite this obvious negative fall-out from its deeper friendship with America, India does not seem to have the appetite to play a more independent diplomatic role in dissociating itself from American foreign policy and reverting, for the sake of expediency, to its earlier non-aligned position.

India has been traditionally suspicious of Western interference in its neighbourhood; it has frowned at suggestions of UN intervention in Kashmir and took its time to become convinced by Norway's mediation attempt in Sri Lanka. Yet India now seems to have realized that it cannot stave off Western and US interest in the region. It is now increasingly working within a multilateral framework to influence and bring about the changes it wants to achieve without appearing to be interventionist.

While generally the US appears to defer to India on matters concerning its neighbours, it remains bilaterally strongly engaged, especially in Sri Lanka, Bangladesh and Pakistan. In the case of Nepal, the US government grudgingly accepted India's more radical change of tack in support of an agreement between the Maoists and Nepal's Seven Party Alliance, but it has remained sceptical of the outcome.

In general, foreign policy observers say that there has been complete congruence in Indian and US policies on Sri Lanka in the recent past. It suits both countries to tacitly support the Sri Lankan government's use of the 'war on terror' paradigm to pursue an aggressive military strategy and it is in the interests of both India and the United States for a political solution to be offered to the Sri Lankan Tamil minority. The US has only limited economic interest in Sri Lanka but its distrust of the Liberation Tigers of Tamil Eelam (LTTE) and its interest in the potentially strategic Trincomalee harbour is said to drive its current engagement in Sri Lanka. India is reconciled to the internationalization of the conflict and has substituted a predominantly economic role in Sri Lanka for its previous political one. Yet, say observers, India manages to remain the elusive deciding force behind international policy on that country.

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## The China factor

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For decades, the Indo-Chinese rivalry dominated Asia's strategic concerns. Greater Chinese economic penetration in Bangladesh, Pakistan and Sri Lanka since the 1990s led to worries of increasing Chinese influence. Since its economic awakening, however, India has been vigorously pursuing a pragmatic policy towards China. Second to the US, India's foreign policy concerns are concentrated on capitalizing on convergence with China, in line with its *Look East* policy. Indian foreign policy experts insist that the old boundary disputes and military tensions, which brought India and China to war in 1963, are 'clearly over' and there is no obvious 'territorial threat from China to India'.<sup>12</sup>

There is a widespread belief that India and China are complementary, not competitors,<sup>13</sup> in the global economy. The economic construct of the *Look East* policy lies in understanding what Jairam Ramesh, Minister of State for Commerce, calls the 'Chindia' phenomenon. Twenty years from now, according to foreign policy strategists, it will be the deep mutual interaction between the two Asian giants that will drive world economic growth. The last decade was marked by a dramatic increase in economic cooperation between India and China, with trade between them rising by almost 30% per year. The complementarities of their industrial interests are striking. China is already India's third trading partner in goods, after the EU and the US. By all measures, India-China trade for 2007 could cross the \$20 billion mark.<sup>14</sup>

An important aspect of the 'Chindia' idea is the growing Indian interest in developing economic relations with the countries of the Association of Southeast Asian Nations (ASEAN).<sup>15</sup> As Kamal Nath, Union Minister for Commerce and Industry, explains: 'Southeast Asia will be an important trade bridge between China and India to create an economic powerhouse in the world'. Despite the obvious economic congruence, however, relations with China remain complex and areas of tension persist. Indeed, the issues that bind the two countries together are also the issues that divide them and fuel their rivalry because of their divergent positions in the international system, contrasting strategic cultures and political systems, and competing geo-political interests. Since 2005, India has found itself pitted against China at the United Nations, at the International Atomic Energy Agency over Iran's nuclear programme, and at the East Asia Summit and the Nuclear Suppliers Group (NSG) over the issue of India's membership.

The emergence of a pro-China axis comprising Pakistan, Nepal and Bangladesh at the 13th SAARC Summit in Dhaka in November 2005 was particularly worrying for India.<sup>16</sup> It has been disconcerted by Beijing's skilful use of economic and military levers to draw Bhutan, Bangladesh, Nepal, the Maldives and Sri Lanka into its orbit, after Pakistan and Myanmar. India has become increasingly aware that its position as the sole benefactor to smaller economies in South Asia is under threat. By offering military supplies and economic investments to Sri Lanka, China has robbed India of

some of its leverage *vis-à-vis* the island. In Nepal, China has already increased its investments and could easily overtake India's bids to develop hydro-power.

For now, New Delhi believes that although China has excellent bilateral relations with all the South Asian countries, it can never usurp India's position in the region. China will have to work doubly hard to claim the 'soft space' within the Indian region – China cannot assume that space naturally. 'We are not looking at a zero-sum game *vis-à-vis* China,' says a foreign ministry official. A shared sense of history, cultural and ethnic commonalities, economic interdependencies, and common borders in the case of Nepal, are all factors which India believes give it a cultural capital China can never procure.

India's claim to its soft power may be overstated. While it shares with its neighbours a deeper cultural heritage, most visibly demonstrated in the cross-cutting appeal of Bollywood movies, this does not necessarily contribute to better relationships. India's smaller neighbours have traditionally resented India's big brother attitude and could easily turn if offered a better option by a rival power. Sri Lanka has been particularly strategic about sharing investments between China and India in its power sector. Bangladesh, despite owing its independence largely to Indian intervention, has refused to entertain India's requests to allow transit to gas from Myanmar which energy-hungry India desperately needs.

India is aware that it has to have a long-term view in countering China, both economically and strategically. In its quest for energy, China has been eyeing the Andaman Sea off Myanmar's coast as an important source of oil to fuel the economic expansion of its western provinces – a development which is not welcomed by New Delhi. Nonetheless, India is willing to work imaginatively within existing frameworks, particularly in the case of Nepal where it sees an asymmetrical advantage.<sup>17</sup> In Nepal, for instance, a practical demonstration of this new thinking could see India warming to the idea of multilateral consortia for investment in the hydro-power sector as a way of diluting bilateral Chinese investments into the Nepalese economy.

## 2 INDIA RETHINKS ITS RELATIONSHIPS

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### A moment of introspection

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In the Indian foreign policy discourse, the period from the mid-1980s to the mid-1990s is often referred to as the 'lost decade'. Some Indian strategic thinkers refer to that phase as one absorbed in 'navel-gazing', in which the atmosphere of rising religious intolerance and violence dissipated any opportunity for growth. It was only after the private-sector-driven IT revolution triggered economic growth in the country, however uneven, that India acquired the self-confidence to wrest its space in the global sphere largely through offering its market of one billion people. With growing economic muscle came a sense that India had allowed its obsessive relationship with its South Asian neighbours to dominate foreign policy concerns for far too long. Or as a senior Indian diplomat says, 'It is time to push the frontier by engaging with the bigger powers as part of building up a new paradigm.'

Yet at this time of soul-searching New Delhi also realized that claiming its privileged position as America's special friend in Asia has implications for its immediate neighbourhood. There were two primary reasons for this rethinking of its relationships in the region: first, the realization that its strategic space within South Asia was dwindling and this in turn was paving the way for other players, notably China and the US, to exert greater influence; and, second, the recognition that India's own policies of 'connectivity' with the rest of the world depend to some degree on a cooperative neighbourhood. India needs, for instance, a supportive Bangladesh which will allow the transit of gas from Myanmar to northeast India. The Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) was a regional initiative encouraged by India to improve trade between South and Southeast Asia.

There are contradictory strands in India's views on the region. But most Indian commentators strongly believe that recent developments have compelled the government to change its tack and pay greater attention to its neighbours. Among these are strong pressures on the government, from Chinese competition and by the domestic private sector, to improve its economic performance. Even those who firmly believe there has been no significant departure in New Delhi's regional policies admit that there has been an attempt to allow economics to trump politics and allow greater integration in the region. While the Indo-US relationship to a large degree has reduced the menu of options in regional relationships, a more pragmatic view seems to be gaining strength, i.e., an understanding that regional integration must take precedence over politics. 'The most crucial problem is that India has lost its constituency. Where is the critical mass of support in the neighbourhood?'; asks a New Delhi academic.

While India's reluctant yet influential role in bringing the Maoists and official political parties together since 2005 has countered some of the negativism towards India in Nepal, distrust is deep-rooted. Indian commentators accept that India has contributed to this antipathy by its massive interference in Nepal's internal affairs. India's backing gave King Tribhuvan of the Shah dynasty the push needed to launch a bid for power against the ruling Rana dynasty in 1950 and, coupled with the armed revolt by the National Congress (NC), provided him with a plank to return to Nepal to set up a new government comprised of the Shahs, the Ranas and the NC the following year. Since then, say a few Indian foreign policy experts, the Indian ambassador has behaved 'like a viceroy' in Nepal.

Apart from political interference, India stands accused of not playing fair with Nepal on resource sharing – primarily water<sup>18</sup> – and trade issues. Through a non-negotiable, unilateral agreement on the free movement of goods and people between the two countries, India gives Nepal duty-free access to all agricultural and industrial exports. In its 2006 budget, however, India imposed a 4% customs value duty (CVD) which raised substantially the cost of exports from Nepal. Yet another contentious issue is the quarantine testing of Nepalese agricultural products. Nepal has been arguing that since India and Nepal share the same agro-climatic zones, India should do away with

these tests, which raise costs and render Nepalese products uncompetitive in the Indian market.

Slowly, India seems to be realizing that small changes in its policies make a huge difference to its smaller neighbours. Indian bureaucrats admit that while there has been one-way free trade between Nepal and India, there has been no progress in investing in Nepal. Nepal remains economically isolated from India, and Indian policy-makers have not gone beyond the traditional conception of aid – ‘of building hospitals and roads’, says an Indian foreign policy expert. They are now beginning to understand that the negative attitudes in Nepal are not about sharing hydro-power with India but about increasing market dependence on one country.

An unresolved historical legacy, political differences emanating from perceptions and realities of its ‘hegemonistic’ past and an ongoing rivalry with Pakistan have combined to play out in the region, gradually diminishing India’s influence. Political differences have become a barrier to regional economic cooperation and development, undermining projects such as the mutually beneficial India–Bangladesh–Myanmar pipeline project<sup>19</sup> and efforts to fully utilize the advantages of regional economic mechanisms such as SAFTA and SAARC.<sup>20</sup> Unlike Northeast Asia, South Asia has not been able to separate politics from economic relationships and this has resulted in the subcontinent being the least integrated region compared to East Asia, Europe, Central Asia, Latin America, the Middle East, North Africa and sub-Saharan Africa.<sup>21</sup> While India’s quest for energy and trade has made some inroads into Central Asia and West Africa, its attempts to draw its immediate neighbourhood into a strategic energy and trade framework have been far less successful.

India’s economic growth has been crucial in shifting mindsets to viewing neighbouring countries as essential arteries for regional trade and resources rather than as security threats. Suspicion has been replaced by a policy of cautious engagement, yet despite mutual economic interests, bilateral relations with Pakistan and Bangladesh remain tense and political differences impede greater cooperation.

India’s foreign minister says it is ready to accept asymmetrical responsibilities, including opening its markets to its South Asian neighbours without insisting on reciprocity.<sup>22</sup> Prime Minister Manmohan Singh has already announced that before the end of 2007, India will allow the Least Developed Countries (LDCs) among its South Asian neighbours duty-free access to its markets. It will also further reduce the number of items marked as ‘sensitive’ in respect of these countries. Yet the concept of economic integration is new to India. For a start, the Indian Union retains tariff barriers between its own states. Despite being a federal republic encompassing 28 states, it is, in itself, not yet a single market.

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## Connectivity through trade and energy corridors

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India’s strategic thinkers believe ‘connectivity’ is the key to realizing regional economic potential. This shift from the traditional national security paradigm of viewing borders as essential to keep out external threats to a more pragmatic thinking which views ‘boundaries as connectors not dividers’,<sup>23</sup> has, since 2005, driven the Indian government to actively forge bilateral, regional and multilateral trade agreements with a host of countries and trading blocs as a new pillar of its economic diplomacy. When fully implemented these trade pacts will cover every country in the wider region from the Persian Gulf to the Malacca Straits and including Mauritius, Israel, Russia, South Korea, the African Union, the European Union and ASEAN.

Realizing that its vision of becoming and retaining its position as a global power rests heavily on energy self-sufficiency, India has pursued its energy diplomacy with vigour. At a meeting in Jakarta in 2005, it called for Asia and Africa to end their ‘anomalous’ dependence on Western governments and companies for the buying and selling of oil and gas, saying it was high time the two continents – which include some of the world’s largest producers and consumers of energy – evolved a ‘framework’ of their own.<sup>24</sup> The needs are pressing: India already ranks sixth in global petroleum demand and by 2010 it is projected to replace South Korea as the fourth-largest consumer of energy, after the United States, China and Japan. With demand for power rapidly



outstripping current supplies of oil, gas and coal, energy and trade are expected to dominate India's foreign policy concerns for the next two decades.

The Indian Ministry of External Affairs (MEA) has been increasingly preoccupied with the issue of a wider Asian energy security architecture and the process of integrating with ASEAN in which the Asian Highway project is seen as key.<sup>25</sup> As a trade ministry bureaucrat noted: 'Without highways and direct connectivity, trade with ASEAN is US\$40 billion. The potential is immense'. Current circumstances favour this change: Central Asia has emerged as a major producer and India and China are two of the fastest-growing economies in the world. Traditional suppliers, too, stand to gain from an Asian market, especially if this means greater stability and predictability in prices.

A landmark agreement, signed in Beijing on 12 January 2006, cleared the way for India and China to collaborate not only in technology but also in hydrocarbon exploration and production. This agreement came close on the heels of a joint bid by state-owned companies Oil & Natural Gas of India and China National Petroleum for Petro-Canada's interest in Al Furat Petroleum, a joint venture with Syrian Petroleum and Syria Shell Petroleum Development. While actively seeking Chinese collaboration in joint energy ventures, energy-hungry India has also been pushing other frontiers. In 2005, it reversed a long-standing policy and opened negotiations with Iran, Pakistan, Bangladesh and Myanmar on a natural gas pipeline. Oil & Natural Gas Corporation (ONGC), India's largest state-run oil explorer, won the right to develop Qatar's offshore Najwat Najem oilfield with an initial investment of US\$20 million.

India's talk of an Asian gas grid and oil market is increasingly finding traction with major importers such as China and South Korea and with suppliers. Yet in its quest for energy self-sufficiency, India has to come to terms with the choices it has made in being accepted by the US. Indian commentators believe that the unwritten aspect of the Indo-US deal will push issues such as pan-Asian hydrocarbon cooperation onto the back-burner. 'The American fear of exclusion from any Asian cooperative structure will undoubtedly put pressure on India and limit its participation at Shanghai Cooperation Organisation',<sup>26</sup> says another foreign editor of a leading Indian daily.

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## **Bilateralism over multilateralism: the triumph of the Sri Lankan FTA**

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Despite its professed and ostensible support for multilateralism, India has been actively seeking alternative mechanisms to expand trade. This has inspired a flurry of free trade agreements (FTAs) within the wider neighbourhood. For Indian policy-makers, the contentious history of the subcontinent has played a major role in slowing the movement on multilateralism: the chronic tension, occasional conflict and perennial absence of trust between India and Pakistan and periodic hiccups in relations with other neighbours have contributed to the uneven progress on multilateral bodies like SAARC. For India, 'SAARC is two decades old and has moved nowhere': existing internal trade between the SAARC countries only amounts to 5% of their total trade. In contrast, trade within member countries of ASEAN and the EU accounts for 22.5% and 55% respectively. Further, the track record of SAARC in resolving contentious bilateral disputes has been less than promising.

India has been traditionally lukewarm about SAARC. There has been for some time an underlying conviction within New Delhi's political and bureaucratic elite that SAARC bestows an undeserved sense of equality on its smaller neighbours, an opportunity for them to gang up to the detriment of India's interests, and that India can prosper more easily if it is not shackled to its immediate neighbourhood. As far as India is concerned, to some degree SAFTA will demonstrate whether the regional cooperative framework can work at all. Yet New Delhi remains sceptical as to whether Pakistan will in the end accept the SAFTA structure. Whether that would derail the initiative or India would go ahead with the others remains an open question.

The Indo-Sri Lankan FTA, on the other hand, say Indian policy-makers, is an example of an economic instrument which has had political consequences – in promoting collective interests and building intra-regional interdependent relationships. There is a firm belief in New Delhi's Foreign Ministry that the Indo-Sri Lankan FTA holds the key to regional integration. Buoyed by the

momentum of an exponential increase of Sri Lankan exports to the Indian market, both sides are eager to expand the present FTA into a Comprehensive Economic Partnership Agreement (CEPA) which will cover investment and services as well, in addition to the current trade in goods.<sup>27</sup>

Apart from the significant increase in trade volume that the FTA has brought between the two countries, Indian commentators talk of the gradual process of integration between India's southern states and Sri Lanka. Nearly 120 flights operate on a weekly basis between India and Sri Lanka and economic interdependencies are beginning to take a denser shape. This reflects a natural leaning towards economic integration based on need, rather than one forced by political expediency.

The FTA negotiations and implementation have not exactly been seamless. In promoting regional trade, India has zealously guarded its own domestic producers. When the FTA was discussed, for instance, the issue of zero-duty imports of hydrogenated vegetable cooking oil from Sri Lanka to India was not an issue as the Indian government's duty structure did not work to the disadvantage of local producers. Successive budgets, however, have raised the internal import duty to 80%, making the playing field for Sri Lankan vanaspati (vegetable cooking oil) importers in India highly uneven. After hectic negotiations, India decided to entrust the National Agricultural Cooperative Marketing Federation of India Ltd (NAFED), a state enterprise, with the task of fixing both the rate of import duty and a quota for imports (250,000 metric tonnes).

Trade ministry officials justify their protectionist approach by saying that third countries, particularly palm-oil supplier Malaysia and pepper-provider Vietnam, could use the 'domestic value addition' (DVA) clause in the Indo-Lankan FTA to export to India. There is also a sense that, given the protectionist regime from which India has emerged, unless it takes measures to protect agriculture, textiles, automobiles, small-scale industry and other critical sectors, these could become vulnerable if opened up too quickly.

The bottom line, according to Indian economic commentators, is that the trade pact with Sri Lanka has benefited Sri Lanka much more substantially than India. India's diversity in production and large consumption ensures that anybody who joins it will gain access to a large market. 'For smaller economies, it is an immensely beneficial arrangement,' says an Indian Trade Ministry official. This line of thinking leads some in India to view its economic relationship with Sri Lanka as a confidence-building measure designed to provide India with a strategic foothold in the Indian Ocean. This economic relationship, they believe, will give Indians additional leverage with Sri Lanka and prevent China and the US from gaining economic dominance.

India's insistence on separating the economic and political dimensions of its relationship with Sri Lanka, and its reluctance to explore the impact of the FTA on the conflict, serve to strengthen the argument that India views the trade agreement more as a political tool. Whether this has any enhancing impact on India's political leverage with Sri Lanka remains debatable.

Some Indian policy-makers believe that the Indo-Sri Lankan FTA brought few political dividends. Sri Lanka's military and economic relationship with two of India's rivals, China and Pakistan, offset any leverage that India commanded as a result of its trade relationship. Others believe that India's reluctance to clinch the Indo-Sri Lanka Defence Agreement and strengthen its military relationship, along with its continued insistence on a political solution to the ethnic conflict, have reduced Indian strategic influence on the island further.

### 3 POLITICAL REALITIES AND PEACE-BUILDING

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#### Economy, security and opportunities for peace-building

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*'Conflict in India's neighbourhood is connected with identity politics; it has nothing to do with its economic relationships.'*

*'The Free Trade Agreement between India and Sri Lanka, despite its positive economic benefits does not provide India with any political leverage with Sri Lanka.'*

(Views voiced by some Indian academics.)

This paper suggests an absence of any trade–conflict causality in South Asia. In other words, trade agreements, whether bilateral or regional, do not seem to have had any positive influence in reducing conflict in South Asia. On the other hand, a reverse causality, where political tensions and conflict between states have hindered trade ties, is apparent in almost every relationship. Geographical contiguity and a shared and complex history have bred prejudicial attitudes in the case of Pakistan, Bangladesh and Nepal but Sri Lanka's physical separateness has helped in improving bilateral economic relations with India.

The adversarial relationship is particularly manifest in the case of Pakistan and Bangladesh but also resonates in terms of resource-sharing with Nepal. Despite strong arguments and evidence in favour of increasing formal trade between India and Pakistan – research by Indian think tanks like ICRIER shows the possibility of expanding annual trade by \$7 billion – political differences continue to stand in the way. Even though energy security is a key component of national security and poverty alleviation and has been given momentum by the Indian government, India's energy needs have had to be sacrificed on the altar of politics in the case of the Bangladesh–Myanmar pipeline.

The case of Pakistan is determined by political considerations rather than purely by economic logic, say Indian commentators. There are very vociferous constituencies on both sides which support economic cooperation with Pakistan; yet the success of the Sri Lankan FTA has still to be replicated. A growing private-sector constituency for trade access between India and Pakistan has triggered intensive research into potential economic benefits from liberalization to both countries and indeed its fall-out on conflict dynamics and peace-building. However, the view that enhanced economic interdependence could lead to conflict mitigation in the Indo-Pakistan peace process has unfortunately not found support at the governmental level. Yet even as the Track 1 peace process between the two neighbours continues to falter over Kashmir and other contentious political issues and has stayed deflected from the trade theory model, the indications are that informal trade has been burgeoning steadily. Estimates of informal trade between India and Pakistan vary between US\$250 million and US\$2 billion – an indication of the vast untapped potential.<sup>28</sup>

While informal trade is said to be minuscule between India and Sri Lanka, since most of it is 'suitcase' trade between Chennai and Colombo, its potential has so far not been studied. Indian strategists have also failed to investigate the impact of the FTA on different provinces within Sri Lanka, most notably the south and the northeast, and its potential impact on the prospects for peace.

That any escalation in the Sri Lankan conflict will inevitably bring an economic cost to India is an issue of which New Delhi is not entirely unaware. Nearly 70% of Sri Lanka's trade with India is through the port of Colombo, the prosperity of which, according to several Indian foreign policy experts, is in fact linked to Indian trade. 'One terrorist attack on the port could wipe this out,' they say, stressing the sense of fragility that exists around the bilateral economic relationship.

The FTA was negotiated prior to the 2002 ceasefire agreement between the Sri Lankan government and the LTTE, yet there is no indication of whether northeast Sri Lankan business representation was sought during trade talks. Given its past involvement in and deep

understanding of the ethnic conflict, the Indian government appears to have taken a very narrow approach by not making the FTA more inclusive in seeking greater regional participation. So far, no systematic study has been conducted exploring the role of India's economic relations with its two smaller neighbours, Sri Lanka and Nepal, and examining the correlations, if any, with peace-building. Indian foreign policy experts seem to think that India's leverage through its economic relationship with Sri Lanka and Nepal cannot be used to achieve conflict resolution within these countries since the conflicts are due to internal political causes and have no connection with India's bilateral relationship.

Officials in India's Ministry of Industries echo the view that despite the success of the FTA, India's leverage with Sri Lanka is not strong. Sri Lanka's economy is well diversified, it has a limited free trade agreement with Pakistan, and is a member of BIMSTEC (the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation), the Bangkok Agreement and the Asian Clearing Union. In short, vital though the Indian FTA is to the Sri Lankans, it is not the only economic arrangement that they rely on.

Unlike China, say Indian political commentators, India has not consciously looked at economics as a way of doing 'bypass surgery' on political issues. China has worked actively to overcome its painful histories with Japan and Taiwan, initiating military and civilian dialogues with the former and expanding cultural and economic ties with the latter. While India did not articulate such a broad strategy, it has made attempts to open up economic engagement with political rivals, China and Pakistan. In the case of China, this has led to an explosion of bilateral trade over the past five years, creating a broader constituency for dialogue. The primary reason for this, say Indian foreign policy experts, was that both governments let their businesses do the talking; they did not mortgage their economic interests to political differences.

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## **Sri Lanka and Nepal: the need for a different approach**

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India's bilateral relationships with both Sri Lanka and Nepal have suffered from mutual suspicion and a high level of mistrust. Nepal, a much smaller, landlocked country which could benefit from greater economic integration with India, views it as a hegemonic power that arm-twists its smaller neighbours for unfair agreements. India, in turn, has accused Nepal of suffering from 'small-country syndrome', imagining non-existent conspiracies and ignoring India's contribution to Nepal's economy.

The need to be involved in the rehabilitation of Nepal as it stands at a new political and economic crossroads is pressing from the Indian point of view. The border area stretching 1,747 kilometres across the Terai in Nepal is of particular interest. Here, an alarming cocktail of Maoist splinter groups, vigilante groups, criminal gangs and pro-royalist groups are creating a situation of deep community insecurity. In this context, economic activity generated through informal trade is important for the economic security of those in the region. More economic engagement, Indian strategists argue, will inevitably reduce the likelihood of young men, in particular, being drawn to violence. This has great political implications for India as Nepal borders five of India's poorest states and the open borders could easily transmit restiveness to India.

Economics smooths out jagged edges, Indian policy-makers are convinced, on the basis of their experience of the 1980s insurgency in Punjab, where political will and economic rehabilitation managed to turn a conflict-ridden state into one of the most prosperous in the country.<sup>29</sup> The Indian establishment believes there is a fair chance that under their new economic regime, the Maoists would support connectivity with India as helping develop the Terai region would work to their advantage. But India also has no illusions that it is a fragile peace that could break down at any time.

With parliamentary elections due in November 2007, Nepal stands at a political crossroads: it could either go down the path of economic regeneration and development or once again become hostage to the crisis of governance that has plagued the country since 1991. Indian policy-makers increasingly realize that Nepal's new political context offers opportunities for India and Indian

businesses. Indo-Nepalese economic relations are governed by the bilateral Treaty of Trade, Transit and Agreement for Cooperation to Control Unauthorized Trade.<sup>30</sup> Interestingly, while all trade treaties between India and Nepal have been concerned about unauthorized trade in third-country goods, with clear reference to the informal flow of goods from Nepal to India, there has been little study of the extent of informal trade from India to Nepal in locally produced goods. Indian policy-makers now believe that the economic relationship with Nepal should cover the entire gamut of economic relations. India has put such an offer on the table and 'it is now Nepal's call'.

It emerges quite clearly that the convergence between India's security, geo-political and economic interests is much clearer and more well defined with regard to Nepal than with regard to Sri Lanka. Porous borders with both India and China make Nepal a strategic and political concern on which Indian government and industry interests converge. The huge potential of the hydro-power sector further increases Nepal's attractiveness to Indian industry.

India's approach to conflict in Sri Lanka is less well articulated and developed. Indian officials appear to genuinely believe that if India starts developmental projects in northeast Sri Lanka that contribute to livelihoods there, it would in some way reduce the likelihood of conflict. Yet Indian policy-makers seem reluctant to explore ways in which the levers of the current economic relationship with Sri Lanka could be used to impact on the ethnic conflict. Further, past involvement in Sri Lanka makes India wary of integrating its political and economic interventions there. To a certain degree Indian policy-makers and the private sector alike, while encouraging and intensifying economic engagement with Sri Lanka, deliberately choose to separate the political from the economic processes and seem unwilling to explore the correlation between the two.

## 4 THE WAY FORWARD: CAN INDIA BE A PEACE-BUILDER?

Despite past experience and messy histories, peace-building within Sri Lanka and Nepal remains a concern for India. This is triggered not just by India's desire to safeguard its own economic potential from regional poverty and economic migration but by a host of other factors. Prominent among these is a desire to build stronger allies with a view to keeping Chinese influence at bay and reasserting India's position as the regional leader *vis-à-vis* the United States and in the global order. As an official from the Confederation of Industry puts it, 'India needs strong neighbours; a weak region will be a liability in the long run.'

Given sensitivities and perceptions within the region, the Indian state is cautious about actively engaging in peace-building there. Not only is it keen to dispel its image as a regional bully, but on a more practical level it lacks the capacity to actively engage in the region. Increasingly, India's policy-makers have become preoccupied with pursuing a special relationship with the United States and aggressively seeking trade and energy ties with a larger neighbourhood beyond the boundaries of South Asia.

The capacity of the Indian state to engage actively in peace-building in Sri Lanka is clearly limited. Yet, it wants to keep some levers of control over the political process, to ensure that Tamil politics remain pluralistic and that the government in southern India offers a political package of devolution to the Tamils, and to attempt to check the influence of China and Pakistan on the country. In Nepal, it sees a clean slate, where equitable development could set it on a growth trajectory towards becoming an essential artery for India's trade with China, a supplier of vital hydro-power and also a strategic ally which owes an unchallenged commitment to its bigger neighbour.

It is only after five decades of independence, say Indian foreign policy experts, that India is showing some confidence in allowing other stakeholders into the realm of foreign policy; until now the entire framework of regional diplomacy was carried out by the government alone. The emergence of a vibrant private sector as an important ally in building regional relationships is not only challenging conventional military wisdom but changing regional dynamics. While most of the movement forward on trade with Sri Lanka and Pakistan seems to have come on the shoulders of civil society and private initiative, there seems to be more reticence by these stakeholders in the case of Nepal and Bangladesh.

Indian trade ministry officials say there is a pragmatic reason for this: unlike China, Japan and other countries in the ASEAN region, India's GDP does not have a huge export orientation. Most domestic manufacturers in India are content with domestic consumption so are not looking aggressively outside. This is the reason why Indian private industry has not been that 'gung-ho on FTAs within South Asia' and has some reservations about opening up the domestic industry. The perception is that since India's export orientation is only 20% of the economy, the gains that would accrue to it would be a small portion while the partner economy would gain access to a huge market.

Yet, if convinced, the Indian private sector could be a potential force for change: the Federation of Indian Chambers of Commerce and Industry (FICCI) and other private-sector interests have had some success in lobbying for stronger economic ties with Pakistan. In 2006, the FICCI and the Confederation of Indian Industry (CII) became *the* political force in putting pressure on President Musharraf to add items to Pakistan's positive list, while the textile lobby succeeded in getting machinery added.<sup>31</sup> The Indian government's negotiations with Sri Lanka on expanding the FTA have been forced to take the concerns of India's domestic vanaspati industry into account. Yet another example of the power of the textile lobby in impacting trade negotiations is visible in the fact that it succeeded in getting the quota on Sri Lankan textile imports linked to the sourcing of raw materials from India. 'We cannot ignore this lobby,' says a trade ministry official.

On a policy level, Indian industry is convinced of the need to economically engage with and support neighbouring businesses as an essential prerequisite for sustained regional development. In principle, the Indian government also appears keen to allow Indian industry to take the lead in shaping the contours of an economic relationship with Sri Lanka and Nepal. However, what currently appears to be absent is the political will to establish such a framework, if it comes at a cost, albeit short-term, to Indian industry. According to a CII official, 'We have advised the Indian government to allow the import of any product from a neighbouring country into India without any duty. We think Indian industry has the muscle to handle this. The neighbours need all the support they can get.'

In the case of Nepal, this scope for further expansion of Indian business interests as Nepal comes to grips with its post-settlement economy and builds an economic framework is most clearly visible to Indian policy-makers. 'If Maoists come to power, they will have to deliver: they are intelligent and extremely pragmatic and realize that economics is one way of effecting social change,' says an Indian academic. Indian foreign ministry officials say that there is a discernible interest by the Indian private sector in Nepal – and this needs encouragement. Already, the CII is organizing functions to expose the Indian private sector to Nepal and there is a sense that this sector is getting much less risk-averse. The entry of this sector, say commentators, will enable Nepal to understand that its destiny is linked to South Asia. Export incentives and bilateral trade incentives from India are far greater than those offered by other countries. From the Indian perspective, despite its size, Nepal is not an insignificant market and could be quite important for bordering state economies such as Sikkim, Bihar and Uttar Pradesh.

Indian industry has been a prime mover for trade alliances. The Trade and Economic Relations Committee (TERC) set up in May 2005 under the chairmanship of Manmohan Singh was largely the result of a process initiated by Indian industry. The TERC acts as the nodal point to assess and advise on all existing and proposed areas of international economic cooperation. With the sub-Saharan region – Angola, Gabon, Nigeria, Sudan, Equatorial Guinea and Chad – emerging as an important source of energy, India is working towards greater economic interaction between Asia and Africa. Indian companies are also taking the lead in becoming the source for cheaper technologies for Africa. 'The world is becoming the oyster for the Indian private sector,' says an Indian foreign policy expert. 'It is at the end of the day the most willing partner to effect change in the region'.

Despite the active involvement of the private sector in Sri Lanka, the absence of any correlation between the political and economic trajectories and lack of any positive fall-out so far from India's intensive trade relationship on the conflict in Sri Lanka may be attributable to the profile of Indian investors. However, this is yet another future area of research which needs to be examined. Most Indian investments in Sri Lanka are by large companies that have the capacity to bear some conflict costs and move their businesses to other destinations should the costs become too heavy to bear. As the Sri Lankan Free Trade Agreement expands to include investments and services, along with trade in goods from 2008, an increasing number of smaller, regional players from south India could become the vital force linking economic and political policy.

This report has sought to make a preliminary investigation into the nature of the correlation between India's growing economic and political clout and peace-building in South Asia. This correlation is clearer with regard to some of India's neighbours than others. In particular, the potential for economic and business linkages to contribute to building peace in Nepal is significant, whereas it is less obvious in Sri Lanka. The report has revealed the need to treat each of India's bilateral relationships with its neighbours on a case-by-case basis. But India's potential as a positive force for regional economic and political stability in South Asia is worthy of further study as it begins to tackle some of the issues that beset a nation with such global ambition and high rates of economic growth, not least the need for new sources of energy. Relationships between private-sector interests in India and neighbouring countries are likely to be key to the success or failure of economic integration in South Asia. The question remains how to nurture such integration in ways that will help build and sustain capacities to deal with conflicts without resort to violence, thereby improving the livelihoods of those living in the region.

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## Notes

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<sup>1</sup> According to brokers' estimate: Goldman Sachs, Morgan Stanley, HSBC.

<sup>2</sup> Based on the IMF 2005 respective growth rates for India at 7.7%, <http://www.imf.org/external/pubs/ft/weo/2005/02/pdf/chapter1.pdf>, and for the EU-25 at 1.6%, <http://www.api.org/aboutoilgas/security/upload/IMF2005a.pdf>.

<sup>3</sup> According to brokers' estimate: Goldman Sachs, Morgan Stanley, HSBC.

<sup>4</sup> Note to investors, Morgan Stanley, March 2007, <http://www.morganstanley.com/views/geflarchive/2007/20070205-Mon.html>.

<sup>5</sup> 'Latest World Bank poverty data shows urgent need to better shield poor in crisis', <http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/EASTASIAPACIFICEXT/0,,contentMDK:20045625~menuPK:208953~pagePK:2865106~piPK:2865128~theSitePK:226301,00.html>.

<sup>6</sup> By 2050, the working-age population of the EU will have decreased by 52 million, whereas India will be the most populous country in the world, ahead of China.

<sup>7</sup> Speaking at the inaugural session of Kolkata-based think-tank Global India Foundation in January 2007, External Affairs Minister Pranab Mukherjee underscored the need for India to 'reposition' itself in an emerging global order and come to terms with its 'increasing weight' in the international system.

<sup>8</sup> Karine Lisbonne-de Vergeron, *Contemporary Indian Views of Europe*, Chatham House/Robert Schuman Foundation, 2006.

<sup>9</sup> 'We have to deal with governments as they exist,' External Affairs Minister Pranab Mukherjee told a group of reporters accompanying him on a three-day official tour of Myanmar on 22 January 2007. He said that India is a democracy and wants democracy to flourish everywhere, adding: 'We are not interested in exporting our own ideology. This is for every country to decide for itself.'

<sup>10</sup> S. Ganguly (2006), 'The Rise of Islamist Militancy in Bangladesh', <http://www.usip.org/pubs/specialreports/sr171.pdf>.

<sup>11</sup> The fence is meant to check cross-border terrorism, arms smuggling and illegal migration. Indian authorities say India faces a threat from Bangladeshi radicals opposed to America's policies in Iraq and Afghanistan.

<sup>12</sup> Lisbonne-de Vergeron, *Contemporary Indian Views of Europe*.

<sup>13</sup> [http://news.bbc.co.uk/1/hi/world/south\\_asia/6157364.stm](http://news.bbc.co.uk/1/hi/world/south_asia/6157364.stm).

<sup>14</sup> Indian Ministry of Commerce & Industry, [http://commerce.nic.in/PressRelease/pressrelease\\_detail.asp?id=402](http://commerce.nic.in/PressRelease/pressrelease_detail.asp?id=402).

<sup>15</sup> Indian trade with ASEAN members grew from \$12.51 billion in 2003 to \$18 billion in 2004.

<sup>16</sup> China and Japan have been granted observer status in SAARC.

<sup>17</sup> 'In the Indo-Nepal treaty on trade, there is a provision for reciprocal transit, so we have suggested that we could think in terms of transit through Nepal, which Nepal would benefit from, which China would benefit from and India would benefit from.' Shyam Saran, former Indian Foreign Secretary, 9 September 2006, Lecture: 'Does India have a neighbourhood policy?', Indian Council of World Affairs, <http://mea.gov.in/speech/2006/09/09ss01.htm>.

<sup>18</sup> Despite huge potential, water resource development has faced many setbacks owing to political and economic factors. Nepal's complaint about getting an unfair deal in treaties such as the Kosi Treaty (1954) and the Gandak Treaty (1959) cast its shadow over future collaborations. Nepal water resource experts complain about India's unilateral initiatives, nominal and delayed compensations and disregard for Nepal's interest and unequal benefits.

<sup>19</sup> The January 2005 tri-nation agreement remains stalled as Bangladesh continues to demand trade parity in compensation for allowing Myanmar gas to transit through its territory.

<sup>20</sup> SAFTA (the South Asia Free Trade Agreement) was agreed among the seven South Asian countries which form the South Asian Association for Regional Cooperation (SAARC) and formally came into effect on 1 January 2006, with the aim of reducing tariffs for intra-regional trade. Pakistan and India are to complete implementation by 2012, Sri Lanka by 2013 and the other four – Bangladesh, Bhutan, the Maldives and Nepal – by 2015.

<sup>21</sup> Intra-regional trade in South Asia is only 0.8% of GDP, one-eighth of Latin America's level and only a small fraction of East Asia's nearly 27% of GDP. Indian Council for Research on International Economic Relations, <http://www.icrier.org/pdf/WP182.pdf>.

<sup>22</sup> Shri Pranab Mukherjee, Minister for External Affairs, opening statement at the end of SAARC summit press conference, New Delhi, 4 April 2007.

<sup>23</sup> Shri Shyam Saran, former Indian Foreign Secretary, in an address at Sapru House, Indian Council of World Affairs, 9 September 2006.

<sup>24</sup> Prime Minister Manmohan Singh's address to the plenary session of Afro-Asia meeting to commemorate the 1955 Bandung Conference, Jakarta, 23 April 2005.

<sup>25</sup> The Asian Highway (AH) project is a cooperative project among countries in Asia and the United Nations Economic and Social Commission for Asia and the Pacific (ESCAP) to improve the highway systems in Asia. It is one of the three pillars of the Asian Land Transport Infrastructure Development (ALTID) project, endorsed by the ESCAP commission at its 48th session in 1992. The project comprises the Asian Highway, the Trans-Asian Railway (TAR) and facilitation of land transport projects. The corridor is expected to improve trade links between East Asian countries, India and Russia.

<sup>26</sup> The Shanghai Cooperation Organisation (SCO), an intergovernmental organization, was founded on 14 June 2001 by China, Russia, Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan. Pakistan, India and Iran received observer status in 2005. Founded initially as a cooperative regional security body, SCO has since prioritized joint energy projects, including the oil and gas sector, exploration of new hydrocarbon reserves, and joint use of water resources.

<sup>27</sup> The Indo-Sri Lankan FTA was signed in 1998 and became operational in 2000. Total bilateral trade with Sri Lanka has grown exponentially; it was \$1,718 million in 2004–05 and grew to \$2,590 million in 2005–06.

<sup>28</sup> N. Taneja, 'India Pakistan Trade', Working Paper 182, Indian Council for Research on International Economic Relations, New Delhi, June 2006.

<sup>29</sup> Punjab has the highest per capita income and lowest poverty headcount in the country. It was ranked second only to Kerala in India's 2001 National Human Development Index; 94% of its population live above the poverty line and 99% of households enjoy access to safe drinking water.

<sup>30</sup> The Treaty of Trade in 1960 was the first that established a bilateral free trade agreement between India and Nepal. It



was subsequently modified and renewed in 1971, 1978 and 1996.

<sup>31</sup> *Pakistan Textile Journal*, 12 October 2006 via [http://ptj.com.pk/newsite/islamabad-outlook/Issue\\_12\\_2006/textile-machinery-import-from-india.html](http://ptj.com.pk/newsite/islamabad-outlook/Issue_12_2006/textile-machinery-import-from-india.html).