Journal of Peace Studies Vol. 14, Issue 1, January-March, 2007.

J&K Economic Union - Blending Politics, Economics and Psychology

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In a Vision Document, 'Achievable Nationhood', J & K Peoples' Conference Chairman, Sajad Gani Lone, has provided a broader framework for the resolution of conflict in Kashmir. However, his chapter on 'Economic Union of J&K' provides interesting details. We are reproducing this chapter from this Vision Document. In this chapter he has used the term J&K S for the state of Jammu & Kashmir and J&K M for Pakistan Administered Kashmir. (Editor)

It is a widely accepted fact in the academic literature, pertaining to conflict resolution, that the implementation phase is perhaps the most precarious phase in the process of conflict resolution. Economics has a central role in the post solution phase, in our model. The role of economics in the eclectic model stretches far beyond the domain of traditional economics and straddles across the political and psychological aspects of the conflict. The concept of an economic union as envisaged in our model impacts psychological, political and economic spheres. There is an economic outcome, but there is also a political outcome and a psychological outcome.

A full economic analysis is beyond the scope of this document. We will, however try to put forward the basic outline of the concept of a J & K economic union within the multi contextual setting of politics, economics and psychology.

Psychological and Political Context:

The political and the psychological impact of the economic union would have to be analyzed in the context of the J & K conflict, and in terms of decades of hostility and lack of an unanimous alternative in terms of resolution. The current status is characterized by an iron curtain between the two regions. There is complete absence of civilized interaction or civilized co-existence in the region. The economic union is a response to a conflict situation and has to be viewed in the perspective of conflict resolution.

The J & K economic union is likely to have inherent in it, elements of psychological union and political union. The concept of an economic union is a process of unification of the two parts of J & K by producing a "single economic entity" out of "two distinct geographical and political sub-entities", having separate political linkages with two separate sovereign entities. A single economic entity would mean free flow of capital, trade, services, labour. Economic operations across the LOC (Line of Actual Control)

and the removal of barriers to movement are perhaps the most profound visible indicators of change- psychological unification. This could be the start of a process of psychological unification which could hopefully intensify with the passage of time. So far the focus has been on the absence of unification between the two parts of J & K, exacerbated by the lack of any interaction between the two parts. An operational economic union shifts the focus on visible aspects of unification-interaction, trade, free flow of capital, movement of goods and services and labour. The concept of the two sub entities being distinct politically and geographically loses its relevance in an era of increased interaction across various spheres. Perceived unification achieved in an economic union makes the demands for real unification less relevant.

In the political context, the short term impact would be opening up of the J&K's territory to the Pakistani citizens for trade and social and cultural interaction. The Pakistan dimension gains accessibility through the state of J&K M into the state of J&K S from a period where the state of J & K S was practically inaccessible to people of Pakistan to a period - where Pakistan is accessible to citizens of J & K S; they can trade, set up businesses and mutually enter into a range of commercial, culture and social activities. Transformation of J&KS from a forbidden zone to an accessible zone signifies great political change in the region.

The long term political impact of the J & K economic union is related to the stability of the arrangements. It will be such an interconnected era that spill over effects on to other spheres are inevitable. And this would translate into establishment of irreversible interdependent relationships across various spheres of economy and society.

Political stability demands institutionalization of interdependence to a degree of irreversibility. Elements of irreversibility can be embedded by moving beyond the domain of governmental policies into the domain of peoples of the region and making interdependence inherently irreversible and that would mean making the interdependent relationships between individuals, corporate entities economically irreversible. Establishment of economic objectives of economic gain, trade among individuals, corporate entities across various economic sectors signifies a diffusion of economic interests across the peoples of the region and vastly broadens the constituency of the stakeholders of stability of the arrangements. This process would set the stage for long term institutionalization of irreversible interdependence.

Application of economics in pursuit of the concept of "economics facilitating politics" is not a unique or new experiment. Application of this concept in the South Asian region has been delayed. Post World War II, GATT was seen as an instrument of promoting world peace. This helped to bring countries like Germany back to the world economic system. The familiar example of the European Union where political rivalries between member states dated back to centuries and yet economics did play a facilitating function of bringing these states together in pursuit of economic objectives with spill over effects spreading to other sectors at a very fast pace.

Economic Context :

The economic impact of an economic union confined to two parts of J&K is not going to be very high. The potential for trade volumes between the two parts of J & K is likely to be very limited. At the very best it would mean increase in trade opportunities of traditional products of J & K S, the volumes of which are least likely to be more than US $ 20 million. The combined economic clout of both the parts would not mean significant changes in employment, industrialization or investment. Confining the concept of an economic union to two parts of J & K at best services limited political and psychological objectives.

The post solution role of economics envisages the transformation of the conflict area - away from the current economic dependence to economic independence. The transformation is essential to sustain a political solution short of the target. The independence of economics is essential to offset the political vulnerability arising out of the perceived loss in politics in terms of a solution being short of target. Although not exactly similar, but economic cooperation between Argentina and Chile provides an illustration. In 1978 both the countries, involved in twenty four territorial disputes, mobilized their armed forces for possible war. And by 1999 the two countries had developed an era of economic cooperation, which saw the blend of Argentinean energy and Chilean capital being optimally utilized.

The economics of the J&K economic union can be optimally realized by broadening the contours of the concept of J & K economic union. This would mean a long term concept of transforming the J & K economic union as a trade friendly area with liberal laws; a nodal trading and production base, designed to service both the Indian and the Pakistani economies as well as international markets. Realization of this concept makes economies of J & K S and J & K M and the J & K economic union, inherntly viable. The traditional concept of a free trade area is that of a port. Envisaging the creation of a free trade area out of a land locked, impoverished area with primitive infrastructural facilities does have its inherent drawbacks. But the emergence of the services industry, prospects of a widened market base by virtue of being able to service both the Indian and the Pakistani economies, possible integration and upgradation of infrastructure and the existence of a free trade, tax heaven, within the “still centralized” Indian and Pakistani economies does provide great potential.

The J & K economic union does have the capability of becoming an island of excellence in areas like banking and finance; other range of service industries i.e. tourism and a shopping destination, by virtue of friendly levels of custom tariffs, software development and centre for media activities related to post production. The J & K economic union could also become a production base. Industrialization has been a problem across both sides of the LOC, mainly because of the small size of the market. Economies of scale can be realized by the prospect of a wider serviceable market base.

The regional and international corporate response to the J & K economic union is pivotal for its success. Far end of optimism would mean internationalization and regionalization of the services sector and the manufacturing sector. It could mean flow of foreign direct investment. Vertical and horizontal integration could see the emergence of regional corporate entities- production facilities spread across India, Pakistan and the J & K economic union. A deregulated, trade friendly economic regime in the middle of India and Pakistan could translate into an economic miracle.

However, the scope of deliverance would be subject to various factors, primarily the extent of facilitation by India and Pakistan. Economics would have to subordinate political and security concerns; a comprehensive regional political economy construct would have to emerge out of conviction.

We analyze some of the basic parameters of the concept of a successful J&K economic union as follows:

a) *Economic system*
b) *Size of market*
c) *Infrastructure - development and integration*
d) *Thrust areas*

Economic System:

The whole concept of an independent economic system revolves around the concept of free trade. If the J & K economic union is to replicate laws in India or Pakistan, it loses its economic relevance. The economic system has to be projected as an alternative. Our concept of economic union is defined by deregulation- low or no custom duties, liberal banking and finance laws, extremely low levels of taxation. Extending the concept to the independence in the internal affairs in the new state of affairs, laws on communication, publishing, civil aviation and other relevant sectors would have to be trade friendly and liberal. The economic system and the other overlapping systems have to be designed in a manner so as to provide ideal settings for the evolution of a liberal economic base with integrated and internationally acceptable levels of infrastructure.

Size of the Market

As per our model, goods of J & K economic union origin would have to have duty free access into India and Pakistan. This means that the J & K economic union would be able to service both the Indian and the Pakistani markets. Apart from that, compared to the existing situation, two parts of J & K would be able to service each other's markets.

So the synergistic size of the market is 1 + 1 = 4. The base i.e. union of two parts J&KS and J & K M would be able to service four markets- India, Pakistan, J & K M and J & K S.

Infrastructure - Development and Integration

Massive investments would be required to transform the current state of primitive infrastructure on both parts of J & K into levels of infrastructure compatible with the vision of the concept of economic union. Infrastructure is an all encompassing concept and would mean development across a whole lot of sectors. Specifically transport, energy and communications would have to be the focus areas which would need to be developed.

The second aspect would be the integration of infrastructure across the two parts of J & K and the capacity to levels of efficiency and capacity so as to be able to serve as a base in an integrated infrastructural base to service the Indian and Pakistani markets.

Thrust Areas

We have identified some thrust areas which we feel could propel economic growth in the future. The economic system and infrastructure needs to be modelled in pursuit of achieving excellence in these areas.

(i) Services sector, (ii) Industrial sector, (iii) Energy sector, (iv) Agriculture and Traditional Sectors

Services Sector

In the long term, the main economic viability of the J & K economic union is mainly going to be derived from the services sector. The Kashmir valley is a beautiful tourist resort and even in times of conflict has been able to attract thousand of visitors. However the emerging scope of the services sector is much beyond tourism and the concept of a regime of liberal laws, along with easy accessibility of Indians and Pakistanis could make the region emerge as a centre for services sector. The scope in the services sector depends on liberal laws, accessibility to latest technology and development of internationally acceptable levels of infrastructure.

The J & K economic union could become a tourist and a shopping destination. Low custom duties and a free trade regime could mean the availability of a range of merchandise from across the world. Liberal trade regime would mean more private sector participation and access to cheap finance for developing the tourism infrastructure. The economic union could be groomed to come up as a centre for media and film related post production activities. The economic union could come up as a

centre for IT, software development, Business Process Outsourcing (BPO), and a host of other activities related to the services sector.

Liberal banking laws, different from that of India and Pakistan could transform J&K economic union as banking and finance centre. The prospect of a base servicing both the Indian and Pakistani economies could stimulate investment. And the source of investment would likely be more than Indian or Pakistani firms. The J & K economic union could host a joint stock exchange. This could extend into J&K economic union becoming a trading hub in South Asia, a hub of buyers and sellers. Common markets of various sectors set up in the economic union could extend to becoming common markets for the entire South Asian region. The concept of the J&K economic union in terms of the service sectors would mean internationalization and regionalization of the contours of the services sector.

The source of competitive advantage on which we will build our whole concept of a successful services sector is liberal trade laws, dismantling of barriers to travel and the possibility of servicing both the Indian and the Pakistani economies.

Industrial Sector

Industries have never succeeded in either of the two parts of J & K. The primary reason has been the puny size of the market and thereby failure to realize economies of scale and very high transportation costs of raw materials. The prospect of an economic union with liberal laws and potential to service both the Indian and Pakistani markets could change all that. The advantage of goods of J & K economic union origin having duty free access to Indian and Pakistani markets could mean setting up of production plants in J & K. Patterns of vertical or horizontal integration could emerge across the region to take advantage of the dual accessibility.

J & K S already has a relatively basic industrial infrastructure. While the Kashmir valley is host to a large number of small scale and handloom industries; the Jammu region has a relatively well developed industrial sector. In the event of industrialization, the regional pattern is most likely to continue across both sides of the LOC. Jammu and Mirpur regions are likely to emerge as industrial centres. Jammu is very closely located to the Indian and Pakistani market, while Mirpur is closely located to the Pakistani market.

Energy Sector

The energy sector should have been a strong variable in scripting economic growth in the region. The state of J & K across both parts of the LOC has been bestowed with abundant hydro power generation potential. It should have been an energy surplus state, exporting energy. The converse exists in practice. The state of J & K S is energy deficit and is dependent on Indian Union to fulfil its energy demand.

A variety of factors mostly political and partly economic are responsible for this situation. The first factor is that the state of J & K across both sides of the LOC does not possess economic sovereignty over its natural resources in the current status of relationship between either, India or Pakistan. The hydro electric projects built in the state of J & K across the LOC, by India or Pakistan are under central control. The state of J & K across the LOC is compensated by giving a percentage of the output as royalty. The second factor is the Indus Water Treaty between India and Pakistan, governing the sharing of river water. This treaty has been signed in exclusion of the people of J & K. The treaty was signed in 1960 and was a macro sharing arrangement across Punjab and the J & K. Most of the current hydroelectric projects in J & K S are caught up in disputes, as Pakistan has objected to these projects on various grounds. The third aspect pertains to those projects which have been executed by the state government. Most of these projects have been mired in administrative inertia and allegations of corruption. Work on some of the projects has been on for decades and completion is nowhere in sight.

We have tried to do some basic economic analysis of the potential of the energy sector in J & K S. This gives an indication of the vast potential of this sector in the economic building of this region. The figures and the data are based on the analysis of the J & K electricity division in response to our questionnaire.

* The total demand for the state of J & K S is approximately 1615 Mega Watt (MW). Out of this the state has an installed capacity of only 475.15 MW and the available capacity is 337.15 in summers and 207.6 in winters. This includes 140 MW from the gas turbines.

* Power generated as part from the above mentioned installed capacity is operated and run by and run for the central government.

* To meet this shortfall of demand J & K S has to pay approximately 1000 crore every year to procure energy from the central government.

* The total hydroelectric potential of the state of J & K S is 20000 MW, while adhering to the Indus water treaty and 25% more if the treaty were not in place.

* The total expected revenue of export of 20000 MW of energy would have been between 15000 to 22000 crores per year at the current prices.

* The total investment needed to build hydro electric projects with a capacity of 20000 MW generation is approximately 120000 crore.

* Out of the this about 60% is the approximate percentage that would feed into the local economy.

* The expected employment potential in hydroelectric projects generating 20000 MW of energy is 120000 skilled and unskilled workers.

Details of the Basic Economic Analysis of the Energy Sector in J&KS[1]

Power generation potential in J & K S, if no treaty was in place and the state was free to exploit its natural resources is as follows:

The approximate hydropower generation in the J & K S is 20,000 Mega Watt, taking into consideration the restrictions due to the Indus water treaty. If however, no treaty was in place the potential is estimated to increase by at least 1/4th i.e. by 5000 MW at the very least.

About 16,243 MW is already identified for power generation projects which have been investigated and found viable both technically and economically on river Indus, River Jhelum, River Chenab and River Ravi.

The Indus water treaty, however, does not restrict the storage on river Ravi.

The break up of the hydel potential thus is:

S.No.	Name of River	Hydel Power generation Potential identified
1	Indus	2066.81 MW
2	Jehlum	3576.55 MW
3	Chenab	10375.00 MW
4	Ravi	225.00 MW
	Total	**16243.36 MW**

98.6% i.e. over 16,000 MW hydel power potential is on the rivers Indus, Jehlum & Chenab governed by the Indus water treaty.

Power generation of J&K S, while adhering to Indus Water Treaty :

The Indus Water Treaty restricts storage capacity (reservoirs) which can be created on the river systems of Jehlum, Chenab & Indus. That means projects dependent upon the actual water flow in the rivers (run-of-the river) can only be constructed. Rough estimates indicate that total energy loss on the Uri and Salal Hydel projects alone on this account is of the order of 44% and 15% respectively.

Tulbal navigation lock, a victim of this treaty, would have resulted in better exploitation of lower Jehlum Hydel projects and Uri-I especially during winters.

Absence of storage discharge has resulted in an immediate loss of 50% capacity which otherwise could have been installed.

S*cope for additional capacity after creation of storages in the upper reaches of the river basin on existing/under construction/proposed schemes:-*

S.No.	Name of Project	Present Capacity (MW)	Additional Scope (MW)	Total (MW)
1.	*Jehlum basin*			
	Uri-I	480.00	480.00	960.00
	Uri-II	280.00	280.00	560.00
		760.00	760.00	1520.00
2	*Chenab Basin*			
	Baglihar	450.00	450.00	900.00
	Sawalakot	600.00	600.00	1200.00
	Dul Hasti	390.00	390.00	780.00
	Pakuldul	1000.00	1000.00	2000.00
	Rattle	170.00	170.00	340.00
	Total	**2610.00**	**2610.00**	**5220.00**
	Grand Total	**3370.00**	**3370.00**	**6740.00**

However, the storage on these basins is governed by the Indus Water Treaty which has provision for creation only of storage as:-

S.No.	Name of Bssin	Provision of Storage
1	Indus	0.40 MAF (Million acre feet)
2	Jehlum	1.50 MAF
3	Chenab	1.70 MAF

Present Power Generation capacity in J&K S

There is a difference between installed and available capacity. The actual available capacity varies between winters and summers. In summer the river discharge is high and consequently hydel capacity is available (subject to availability of machines). But the available hydel capacity goes down in winter normally by at least 66% (approx.)

The installed and available capacity (water availability) is roughly given in the following table:-

S. No.	Name of Power House	Installed Capacity (MW)	Available Summer	Available Winter
A				
1	LJHP	105	100	40
2	USHP I	22.60	12	5
3	USHP II	105.0	35	0
4	GBL	15.0	8	3
5	Karnah	2	1	0
	Sub-Total	249.60	156	48
B	Chenab Basin			
1	Chenani I	23.30	15	8
2	Chenani II	2.0	2	0.60
3	Chenani III	7.0	7	3
4	Rajouri	0.70	0.6	0
	Sub-Total	33.0	24.6	11.6
C	Ravi Basin			
1	Sewa III	9	9	8
	Sub-Total	9	9	8
D	Indus Basin			
1	Iqbal Bridge	2.75	3.75	0
2	Hunder	0.40		
3	Sumoor	0.10		
4	Buzgoo	0.30	0.80	
5	Satkna	4.0	3	0
	Sub-Total	8.55	7.55	0
Total Hydel		**300.15**	**197.15**	**67.6**
Gas Turbine		**175.00**	**140**	**140**
Grand Total		**475.15**	**337.15**	**207.6**

Gas turbines being very expensive are rarely used and then only to meet the energy requirements during extreme shortages for peak time.

Present demand for power in J&KS.

The demand for energy in 2003-04 was recorded as 8600 Million Units (Mus) i.e. an average of 235 lac units/day. The peak demand in MW, i.e. maximum load demand, was recorded at 1615 MW.

Tariffs paid by the State of J&K S to procure power from New Delhi.

The cost of purchase of power from outside the state is a derivative of a complex mix of parameters, both technical and others, fluctuating with the time of the day and system frequency. An average is worked out for the day, week, month and the year as needed. Total power purchase for the year generally is a net figure accounting for the energy outflow as well.

The total amount paid by the state on account of energy bills is as follows:

Year	Amount in IRS
2001-02	IRS 879.02 crores
2002-03	IRS 1280.87 crores
2003-04	IRS 1390.52 crores

Conversion of energy in to revenue

One Mega Watt (MW) means 1000 kilowatts, One Kilo Watt (in terms of load) is equal to 10 lamps of 100 watt each.

When 1 KW load (i.e. equivalent of 10 lamps of 100 watt each) is used (ON) for one hour, it is called a Kilo Watt Hour (KWh) or a unit of electric power. Electric energy consumed is measured as KWh (units) of energy electric energy meters.

Now when 1000 KW (1 Mega Watt) load is used for one hour, it consumes 1000 units of energy.

So 1000 MW would be 1,000,000 KWs (One million KW) and in one (1) hour, this load shall consume 1 million KW 1 hr = 1 million Kilowatt Hrs = 1 million units or 1 Mu.

Now suppose we export this (1 Mu) energy for at least 8 hours / day and for all the 365 days of a year,

i.e. = 1 ‘ 8 ‘ 365 Mus
= 2920 Million Units export.

Our recent average rate of energy purchase from outside the state is about Rs. 2.56 (in 2004 - 05 till date).

After applying the same rate , the export of 2920 Mus energy @ Rs. 2.56 / Unit will earn a revenue of about Rs. 7475 million i.e. = Rs 747.5 crore (for exporting 1000 MW for 8 hrs a day round the year). And Rs 1121.28 crore (if we export 1000 MW for 12 hrs a day round the year).

So the potential for revenue even when the Indus Water Treaty is in place would be in the range of IRS 14950 crore to IRS 22425.6 crore. In dollar terms it would be between three to four billion dollars.

Infrastructure cost of putting up of hydro electric projects.

Hydro Electric power projects are highly capital intensive and are generally located in difficult mountainous terrain, being dependent upon the "head" of water to create water pressure to run large water wheels (turbines) which in turn, being connected through shafts run electricity generating machines.

Although the infrastructure establishment cost is location specific, in very general terms the recent cost of putting up hydel power projects in J & K S works out to around Rs 6.0 Crore per Mega Watt. For 1000 Mega Watts it would proportionately mean around Rs 6000 crore. Approximate investment required for generation of 20000 MW units of energy would be 120000 crores.

Impact on local economy

A large Hydro electric project charges the locale drastically by infusion of men and materials, opening up the hinterland and creating demand of both manpower and suppplies which in turn impacts favourably upon the local economy pumping as much as 70% of the total project cost. On an average, it is seen that about 60-65% of the project cost is spent locally - especially on all civil works including compensations for land acquired and un-skilled employment etc.

Employment potential in numbers to run the Hydro electric projects

Every hydro project has vast potential for employment for engineers/ skilled & unskilled personnel, besides support staff, depending upon its size, type and location. In developed countries, only very few highly skilled personnel are developed to run comparatively large power projects. In our part of the world, the emphasis now is towards optimal efficiency on the minimum requirement basis. On an average in India, every one MW capacity may need about 8 skilled/un-skilled personnel. This means a total employment potential of skilled and unskilled workers for 20000 MW would be 160000.

Agriculture and the Traditional Sectors

An exploration of the agriculture sector, including horticulture, floriculture, etc., and the traditional sectors, including handicrafts, etc., is beyond the scope of this document. These sectors are significant both in terms of the cultural attachments, the employment they generate, as well as the bottom lines they represent. In the new state of affairs, and

the new markets they will create, these sectors will be thrust areas and due attention towards them will spur economic growth. The new market forces would offer new economic opportunities and would spur modernization, privatization, commercialization, and/or other needed changes within these sectors.

[1]*Details (in this chapter) have been provided by J & K Electricity department in response to our questionnaire.*