

## Policy Making in a Terrorist Economy

by DIPANKAR SENGUPTA

### Primer: The Economy of Jammu and Kashmir

The economy of Jammu and Kashmir before the beginning of the insurgency that beset it in 1990 had been primarily an agricultural economy. There was very little industry (although Kashmiri handicrafts created a niche for themselves) and the service sector was dominated primarily by tourism. These sectors of the economy, which brought in cash to the state, depended heavily on customs from the rest of India. Apples from the valley of Kashmir found their markets elsewhere in India, while tourists from different parts of India buoyed local tourism and handicrafts. Indeed, given its low population the narrowness of Jammu and Kashmir's domestic market could not be expected to support rapid growth of the state's economy. Thus integration with the wider national market was of vital importance to the state's economy.

The manner of this integration was not merely a unification of markets but also free transit for the citizens from the rest of India. This, it may be noted, had been achieved only in 1953—five years after the state's accession—following an agitation led by Shyama Prasad Mookherjee, founder of the Bharatiya Jana Sangh (Indian People's Union), against the identification card rule that was seen to be a hindrance to the free entry and exit of people from other parts of India. Jammu and Kashmir's economy was therefore tied to the national economy of the country. Given the fact that the Indian economy did not quite take off in the first three decades after independence, neither did that of the state. It may be noted that the strengths and weaknesses of the state's economy reflected its terrain. Except for some areas in Jammu and the valley, the state is mountainous, ensuring that transport costs would be high. Consequently, the state could have a cost advantage only with those products where it had a monopoly or high value-low volume items where high transport costs could be neutralized. The state was and remains the highest producer of apples in India, as well as a host of dry fruits and traditional handicrafts that fitted this criterion. But the state then and even now added very little value to raw fruit that it produced, thus missing an opportunity to supplement its poor creation of gainful employment. Such a step required an economic regime that would allow entrepreneurs to take advantage of opportunities and set up plants and factories as freely as possible. However, India's economic regime prior to 1991 was governed by a system of permits and licenses and did not allow for

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such autonomous efforts on the part of independent private agents. Therefore, in spite of tremendous potential in terms of raw material available, agro-industries never took off. Thus, three decades after accession, the sectoral composition of the economy of Jammu and Kashmir was as described in Figure 1, below.

There was marginal change in the decade that followed and the overall composition of the Jammu and Kashmir economy remained the same.

The onset of insurgency was a major blow to those sectors of the economy that were linked to the money economy. However, different sectors of the economy coped in different ways with the result that the trajectory of evolution of each sector differed dramatically. Some sectors were obviously very badly affected. Others were forced by circumstances to take steps, as a result of which they did amazingly well without any government effort. A study of these various sectors in a milieu of economic uncertainty and government policies in those settings is extremely important for a better comprehension of how agents react under these circumstances. The lessons learnt from such a study have policy implications and are directly linked to the possibilities of a peace dividend.

### Sectors Badly Affected: Tourism

The insurgency completely crippled the tourism industry in the Kashmir valley. Tourist arrivals that had numbered over 700,000 in 1988 and over a half-million in 1989 fell to little over ten thousand in 1990. Kashmir valley tourism was not to witness a return to six figures until 1998, when it barely crossed a hundred thousand. It doubled the following year but fell off after the Kargil conflict with Pakistan that year. The valley remains attractive to

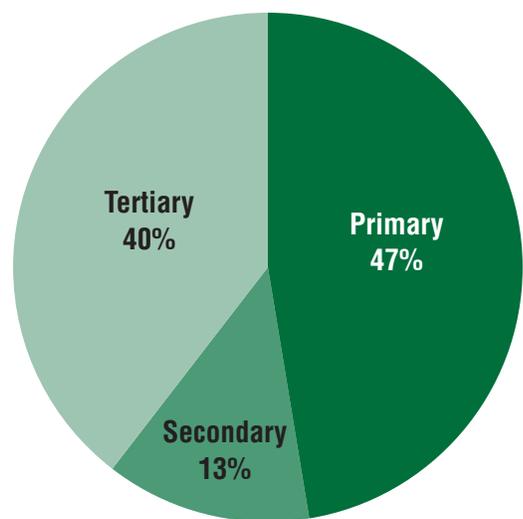


Figure 1 • 1980–1981

tourists even with the threat of terror. Indeed, tourists have to be specially targeted by terrorists to dissuade them from visiting the valley. The possibility that this dissuasion is planned is heightened given that the tourist groups chosen for attack (usually grenade attacks) have been from West Bengal and Gujarat where Kashmir has been a favorite destination. This is not to say that the entire state witnessed a decline in tourist arrivals. The other regions of the state, Jammu and Ladakh, were less affected. In fact, outstation tourist arrivals in Jammu rose from two million to over four million in the 1990s. Ladakh was of course more affected, but numbers never fell precipitously as in Kashmir. Jammu's tourism was pilgrimage tourism mainly centered on the Shri Mata Vaishno Devi Shrine. But in contrast to Kashmir, the bulk of arrivals in Jammu came from a lower economic stratum and the amounts that they spent reflected this characteristic. Thus, even as the number of pilgrims to the shrine crossed six million in 2006, tourism generated only Rs 450 crores (approximately \$110 million) for the region, a modest sum given the absolute numbers involved.

### The Potential Peace Dividend

Tourism as an industry naturally relies on peace and stability for sustenance. Tourist arrivals in the various regions of the state reflect this, in the sense that numbers in each division depend on local law and order conditions as well as proximity to conflict zones. This is why Ladakh suffers. The peace dividend for this sector therefore could be enormous. For one the synergies that complementarities between Jammu and Kashmir provide could lead to a massive boost in tourism in both places but more significantly to the valley. Religious pilgrims to the Mata Vaishno Devi Shrine or the Shrine of Baba Ghulam Shah Badshah at Rajouri (also in Jammu Division) could easily travel a bit further—via a new rail link that now will connect the Valley to the rest of the country for the Vaishno Devi pilgrims, and via the Mughal Road for the pilgrimage tourists in Rajouri. Thus the Valley would gain by mere proximity to Jammu. But more importantly, India's burgeoning middle class—a product of India's economic liberalization policies and a class that is no longer afraid to spend, and which seeks to travel to neighboring Himachal Pradesh to cool off during summer, swelling tourist arrivals there to over 5 million—would also look to the Valley to cool off. It is well known that Jammu and Kashmir has all the geographical features of Himachal and more to attract tourists of all hues, from adventure tourists, to eco-tourists, to religious tourists, to those who merely want to “get away.” What it does not have is safety and security. This is partially true also of those areas of Jammu that would compete with the Valley for the same kind of tourists.

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► The insurgency completely crippled the tourism industry in the Kashmir valley.

► The 1990s witnessed a sharp decline in infrastructure in the state, due to sabotage by militants and neglect.

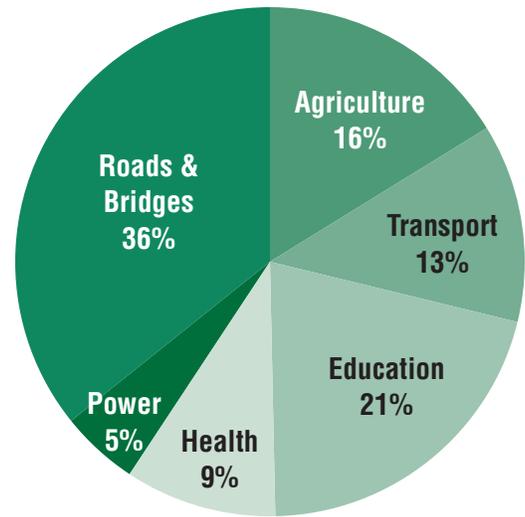


Figure 2 • Destroyed Infrastructure: Sectoral Impact

Secondly, these parts of Jammu that border Himachal Pradesh also lack the necessary infrastructure, with existing infrastructure having been severely degraded in the 1990s due to neglect forced by the insurgency.

### Infrastructure

The 1990s witnessed a sharp decline in infrastructure availability in the state. Some of this was due to sabotage by militants targeting social and physical infrastructure. Neglect played its part also, especially when it came to assets like roads in hilly terrain with considerable precipitation.

Figure 2 above reflects the impacts of the infrastructural damage. While transport infrastructure damage—that is, vehicles damaged—could be very easily replaced, this is not true for roads and bridges. Given the fact that the money economy of the state is particularly dependent on connectivity with the rest of India for its survival, the damage to sectors like horticulture was immense. Before the targeting of infrastructure, horticulture exports to other states had not been affected by militancy. But the years following 1993-94 witnessed a precipitous trend, from which this sector would recover only in 2000.

This again is not unusual. Horticulture is a local activity carried out largely with the help of local people. Horticultural production *per se* does not depend on law and order in the sense that tourism does, as local people are not targets of attack by militants. But when infrastructure is targeted (as shown in the figure), the outcome cannot be in doubt. However, with the security forces gaining ascendancy over the militants in the valley, widespread targeting of infrastructure is no longer that easy. More importantly, it draws local ire, alienating the very

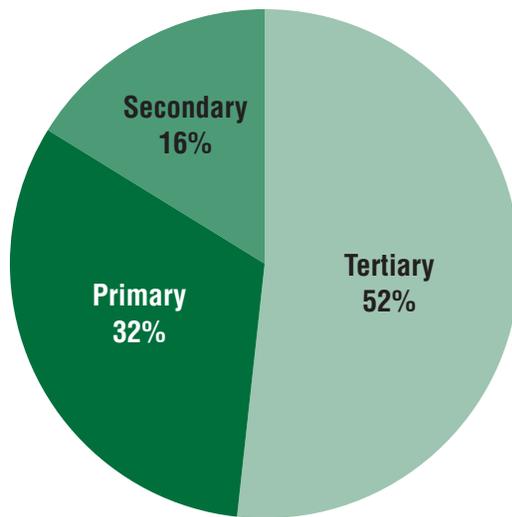


Figure 3 • 2001-2002

► The central government came in with packages to revive the economy through grants intended to restore infrastructure and other parts of the economy, resulting in a sectoral break-down that defied common economic logic.

► The state “development” practices ended up making militants richer while entrenching the institution of corruption deeper and deeper.

people whose support militants must have to operate successfully.

#### Government Policy and the Creation of a Terrorist Economy

The state’s response to an economy damaged by militancy developed along predicted lines. As in North East India, the central government came in with packages aimed at reviving the economy through grants intended to restore infrastructure as well as other parts of the economy. The effect of all this was to create an economy whose State Domestic Product (SDP) sectoral break-down, as given by Table 1 and Figure 3, defied common economic logic. The ultimate twist to this bizarre economic history was the revelation by the National Sample Survey Organisation that Jammu and Kashmir ranked highest of all the states when it came to per household asset ownership in the country, with Rs 10.87 lakhs (approximately \$27,650) per household.

The profile of economic activities, with its accent on construction and public administration and substantial contributions from banking and real estate, would be puzzling to most economies. The revelation about asset ownership only compounded the puzzle. There is of course little doubt that the massive increase in the number of security forces sent to this troubled state and the expenditures made locally to maintain this force would have an expansionary effect on the local economy.

But it also now increasingly clear that as in the North East, the economic packages announced by the central government would follow a particular trajectory that would deliver similar results. As “packages” and “projects” were announced, the preferred vehicles of delivery were contractors who or at least

Table 1 • Composition of J&K SDP: 2001-2002

Sector	Magnitude (Rs crore)	(% share)
Agriculture	3902.75	27.64
Forestry and logging	493.84	3.50
Fishing	102.52	0.72
Mining & Quarrying	14.67	0.10
<b>Subtotal: Primary</b>	<b>4513.79</b>	<b>31.96</b>
Manufacturing (reg.)	175.82	1.25
Manufacturing (Unreg.)	550.35	3.90
Construction	2087.66	14.72
Electricity, Gas & Water	-478.66	-3.39
<b>Subtotal: Secondary</b>	<b>2326.48</b>	<b>16.47</b>
Transport, Comm. and Trade	720.04	5.10
Trade, Hotel and Rest.	1424.53	10.09
Banking and Insurance	627.42	4.44
Real Estate	773.09	5.47
Public Administration	2184.30	15.47
Other Services	1551.94	10.99
<b>Subtotal: Tertiary</b>	<b>7281.32</b>	<b>51.56</b>
NSDP	14121.59	100
Population	102.83	
Per Capita	13733	

whose political patrons reposed their faith in the Indian Constitution. The mode of awarding contracts remained opaque. Such businessmen soon attracted the attention of the militants and became easy targets for extortion. It may be argued that there was social sanction for this treatment not the least because the manner in which these contracts were secured were not seen to be above board. The relations built up by the businessmen and the extorting militants had some serious consequences. As long as the money was paid, the business operations of the businessmen would not be targeted. This of course assumed that the militant who received these sums was capable of maintaining sufficient discipline in his cadre to prevent others from targeting businessmen who paid up. However, should such a person be killed by the security forces, it meant that fresh arrangements would have to be made between the businessmen and the militants who succeeded their slain comrades. Indeed, the killings of migrant laborers in June 2006 happened just after the security forces killed a top militant. The killing of the laborers was not an act of retribution but a signal that a new set of militants had arrived and new “arrangements” would have to be made. In short, while the state had in place a system of “development” practices aimed at buying

the “hearts and minds” of the people, what it ended up doing was to make militants richer while at the same time entrenching the institution of corruption deeper and deeper into the culture of the state. It is no wonder then that Transparency International India finally ranked the state as “most corrupt,” relieving Bihar of this dubious honor.

It is this system of transfers that led to the state being a massive consumer of white goods, automobiles as well as a source of financial investment, a totally unexpected state of affairs for a region bogged down in a quagmire of violence for over a decade. The poverty ratio for the state had plunged to a very low and enviable 3.5%, compared to the national average of 26.1%. Of course, military expenditures in the state cannot entirely account for this dramatic fall in poverty. It must be remembered that unlike most parts of India, land holdings were fairly equitable as a result of successful land reforms carried out by Sheikh Mohammad Abdullah’s government during his first stint as Prime Minister of Jammu and Kashmir. Thus, asset inequality in terms of land holdings had long been addressed with its obvious impact on poverty. But the fall in poverty rates especially at a time of sustained militancy only pointed to open and surreptitious transfers, which while mitigating poverty entrenched the already existing system of corruption even deeper.

### Handicrafts

The sector that did remarkably well during this period was the handicrafts sector. Employment in this industry increased throughout the 1990s from 225,000 workers directly employed to 320,000 in 2001. Since this industry is in private hands, it may be assumed that this represented gainful employment. The growth occurred at the same time when the total number of training centers declined from 635 (1994) to 535 (2000). While the total number of cooperatives set up to help artisans market their wares almost doubled in the 1990s, their combined sales almost halved. On the other hand, the state-owned Jammu and Kashmir Handicrafts Corporation did a far more impressive job by upgrading its Management Information Systems and ensuring that its total turnover increased from Rs 5600 million (\$142 million) in 1994-5 to Rs 8690 million (\$220 million) in 2000-1. The total expected turnover (domestic sales plus exports) in 2007 is in the range of Rs 15,000 million (\$381 million), but there are observers who claim that this is a conservative estimate and that the actual figure is at least twice this number.

What is noteworthy is that the bulk of this trade takes place beyond the aegis of the state and through private hands un-aided by the state. This again is ironically due to the militancy that swayed the state in the 1990s. Itinerant Kashmiri handicraft

merchants forced into hawking their wares house-to-house in many Indian cities became a common sight. This strategy was necessitated by the fact that a major source of demand—tourists—had stopped visiting the valley. Soon Kashmiri handicraft dealers had hit upon the novel idea of setting up shop in those parts of India where visitors thronged, such as Goa, Delhi, and Kerala. Thus, Kashmiri handicrafts facing the vicissitudes of militancy adopted such measures and tactics whereby they were able to overcome the limitations of the market defined by tourist arrivals in the Valley and integrate themselves with the national and global economy. This sector did so without much help from the state and in extremely difficult conditions. They were able to do so because handicrafts remain a business where much of the production takes place indoors. Curfews do not affect production and demands on infrastructure are few. Thus production is not affected by militancy. The nature of its markets does not call for a “just-in-time” system, and as such small disruptions in supply are easily absorbed.

This is in marked contrast to sectors such as small and medium scale enterprises, which have not been able to wean themselves from generous subsidies to compete and integrate with the national market. Thus, the state of Jammu and Kashmir represents a paradox where sectors that are relatively unaided have managed to carve a niche for themselves in the global economy, while sectors that are the recipient of state largesse have not been able to do so.

### Policy Implications

What policy implications may one derive from India’s Kashmir experience viewed through the prism of economics? It is clear that the central government’s effort to bribe the state into submission has not worked. It is also clear from the success stories in the handicraft sector that such an approach is not warranted. What is needed is a participatory approach to economic policy and development.

The destruction in rural infrastructure, which needs to be repaired, should see the involvement of village councils (called *Halqa Panchayat* in the state). The centralized manner in which these tasks are planned in the state currently involve the District Collector, the Members of Legislative Assembly who belong to that district, and the Member of Parliament under whose constituency that district falls. Popular involvement in planning and execution is totally absent. While the 73rd and 74th Amendments to the Indian Constitution have given constitutional status and some financial teeth to the local bodies in the rest of India, this is not true in Jammu and Kashmir which *vide* Article 370 has its own constitution. The state’s local level bodies are disempowered and elections are irregular. Thus an important instrument of

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► A participatory approach to economic policy and development in Jammu and Kashmir is needed, including the involvement of local popular bodies like village councils.

local empowerment, policy planning, and implementation is absent. It is doubtful that these bodies will be targeted by militants for extortion, as that would alienate the very people whose support or at least silence is necessary for militancy to thrive. The lack of use of local popular bodies to create rural infrastructure instead of private contractors chosen in a centralized manner through dubious means does little to reduce popular alienation or re-create infrastructure. What it leads to is a skewed income and asset distribution apart from enriching the militants. Similarly, steps taken in the direction of entrepreneurship training among local residents so as to enable them to set up enterprises on their own is a more sustainable model than setting up state-owned enterprises. These activities, especially in the areas of adding value to horticultural produce, can do much to generate incomes and employment. Making them targets of extortion by militants may not be accompanied by the same social sanction as in the case of extortion of government contractors.

So far, neither the state government nor the central government has moved in this direction, although most recently the central government has prodded the state government in the direction of democratic decentralization. This clearly is an opportunity lost, as the goal of economic development need not be given up even when an insurgency is on. But in a milieu where years of “easy money” accentuated by “security concerns” create an impressive array of vested interests bolstered by casualty graphs that point downwards accompanied by surprisingly steady numbers of militants waiting to infiltrate into India, resources keep on flowing in the same manner and volume as previously. In such circumstances, policy shifts—especially radical ones—are the first casualties.



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*Source for all figures and tables: J&K Economy: Reform and Reconstruction. A report on economic needs assessment. Asian Development Bank (June 2004).*

## Kashmir and Water: Conflict and Cooperation

by SEEMA SRIDHAR

### Water, Wars, and Kashmir

Conflicts over water—a precious resource, the supply of which is growing sparser and the demand for which is ever mounting—have been much talked about by experts. Growing populations and extending development would render conflicts between water-rich and water-scarce nations inevitable. Upstream states that control the flow of water to downstream states would use this valuable resource as a key diplomatic and strategic tool to coerce the downstream nations into submitting to its demands. According to the 2002 United Nations World Water Development Report, there were 507 conflictive events over water during the previous fifty years. Thirty-seven among these involved violence, of which 21 consisted of military acts (18 between Israel and its neighbors). “Some of the most vociferous enemies around the world have negotiated water agreements [concerning international rivers] or are in the process of doing so,” says the report. Global warming would act as a catalyst to water-conflict scenarios, with decreasing rainfall and increasing evaporation in some areas that have made the regular climate patterns erratic. Intermittent phases of flooding and droughts causing massive human suffering would pressure governments into turning off the taps to its neighbors.

The Indus River, whose basin cradled one of the oldest civilizations of the world, sustains Pakistan today. Both India and Pakistan depend on snow-fed rivers that rise in the Himalayas. Pakistan depends on the Indus for its survival and sustenance. The Indus, moreover, passes through Jammu and Kashmir, which is in dispute between the two countries. The history of water sharing between India and Pakistan has been marked by exceptional cooperation and intermittent conflicts over the interpretation of the water sharing treaty that forms the basis for this cooperation. The Tulbul Navigation Project and the Baglihar, Kishanganga, and Salal hydroelectric power projects are a few contentious issues between the two countries revolving around the Indus Waters Treaty (IWT). The incongruities in interpretations of the IWT have been attributed to political motives, rather than differences over technical and engineering aspects of water management.

### The Indus Waters Treaty: Emergence of an Effective Conflict Management Tool

The IWT brokered by the World Bank (WB) provided for the division of the rivers between India and Pakistan. The eastern rivers—Sutlej, Beas