



Rejuvenating the economic environment in Jammu & Kashmir

Mapping the potential of investments across various regions

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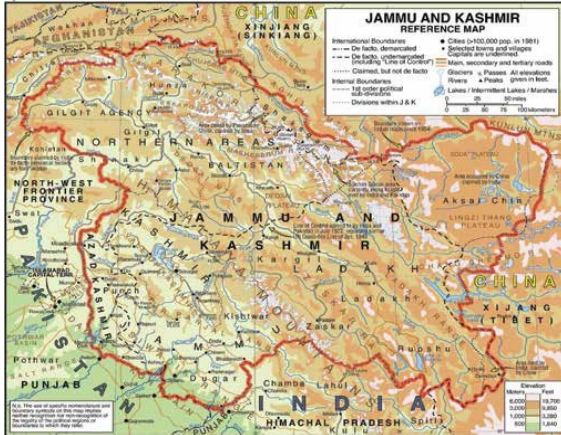
Glossary

The glossary provides a broad definition of the terms used in the study, based on accumulated experience and use in relation to Jammu and Kashmir's political history and the peace process.

Erstwhile state of Jammu and Kashmir	The undivided state of Jammu and Kashmir as it existed in August 1947, prior to Partition.
Jammu and Kashmir	Interchangeable with the above unless otherwise stated.
Kashmir	For the purpose of this study, the generic name for the state and sub-region, unless otherwise stated.
Line of Control (LoC)	Post-Simla Agreement adjustment of the existing 1971 ceasefire line, based on actual control.
LoC-East	A technical definition of Jammu and Kashmir on the Indian side.
LoC-West	A technical definition of Jammu and Kashmir on the Pakistani side.
Separation line	Denotes the divide in Jammu and Kashmir, whether the outcome of 1948 ceasefire or its successor 1972 LoC.
Stakeholders/competing powers	Broadly used to refer to India and Pakistan, relevant inhabitants and 'neighbourhood' all fall under this category.
Azad Jammu and Kashmir (AJK)	Areas in LoC-West administered from Muzaffarabad.
Crores	A crore (abbreviated cr.) is a unit in the South Asian numbering system equal to ten million (10,000,000; scientific notation: 10^7), which is written as 1,00,00,000.
Lakh	A lakh (also lac; abbreviated L) is a unit in the South Asian numbering system equal to one hundred thousand (100,000; scientific notation: 10^5), written as 1,00,000.
Rupees	Where rupees are used to denote currency in LoC-West, USD/PKR 105.8. Where Rupees are used to denote currency in LoC-East, USD/INR 62.5. (United Nations Treasury – Operational Rates of Exchange, September 2013).

Front cover pic caption. © Conciliation Resources

Summary



Investment in Jammu and Kashmir has the potential to generate wealth in the region and fuel regional growth. Not only is there opportunity for capital appreciation, investment could have a positive impact in the region, improving cross-border trade and communication.

Although the current economic structure of the region poses limits on the potential of cross Line of Control (LoC) trade, the economies of LoC East and West are relatively small and lacking efficient production structures.

To effectively increase trade, a new structure needs to be implemented, that promotes integration across the various legal, political, economic and social divides in Jammu and Kashmir. The study argues that investments in either side of the LoC will lead to these issues being gradually resolved and establishing long-lasting trade.

Current Business Climate

The disconnect between the two parts of Kashmir has prevented wider and more vibrant economic activity in the region, leading to dependency on India and Pakistan and 'artificial respiratory mechanisms'. This has led to separate development trends across the two sub-regions, each having different characteristics in terms of their business and regulatory environment.

Currently, the small scale, cross-LoC barter trade initiated by India and Pakistan since 2008 as a confidence building measure faces the constraints of a small market, and needs to be backed up by other tools if it is to change significantly. Economic rejuvenation would need a re-designed trade regime and for policy makers to promote entrepreneurship and capital investment as new drivers to the stabilisation process.

The vast amount of remittances sent back to Jammu and Kashmir by the diaspora illustrates the potential for foreign investment. This could be furthered by greater trust in the investment climate and flow of information.

LoC West

- The economy is dominated by services, followed by agriculture with industry taking a backstage.
- Land is scarce with only 13% being cultivable, however the region is rich in human resource with a literacy rate of 64%.
- Policies made in Islamabad have a profound impact on business in the region. A good level of law and order, conducive for business activities.
- Banking infrastructure supervised and regulated by the State Bank of Pakistan. Lending is very limited, accounting for 5.7% of deposits in 2011, largely due to perceived difficulties in the lending facilities and lack of security on returns.
- Trade in AJK is interwoven with the neighbouring markets of Pakistani provinces. Cross LoC trade is a new phenomenon with trade amounting to \$211 million in 2012, however its impact on the economic rejuvenation of the region remain uncertain.

LoC East

- The economy is dominated by services (54.89%), followed by industry (24.55%) and agriculture (20.56%).
- Being a hill economy and given its distance from the main markets in India, transportation costs are high.
- The governance of the state is influenced heavily by the central government of India. Concessions are in place to attract industry, and build the state's industrial base. The land is as open to investment as any other in India, even allowing investment from Pakistan.
- Banking and financial institutions in LoC-East are subject to the supervision and control of the Reserve Bank of India. With the current loan ratio at 34.36%, with the stipulated target being 40%. This shortfall is in education, small enterprise and micro-credit, suggesting entrepreneurship still hasn't taken off.

Kashmir at a glance	LoC West	LoC East
GDP (USD Billion)	3.2	15.2
Area (Km ²)	13,297	101,387
Population	4,000,000	12,548,925

Banking at a glance	LoC West	LoC East
Total Deposits (Rs Cr)	38,100	55,144
Loans (Rs Cr)	1,030	18,949
No. of Bank Outlets	441	1,302

Investment Potential

In the industrial sector it is clear that on both sides of the LoC, extractive and mineral processing industries constitute a potential area of investment. Thus, cement and marble extraction are potential areas where investors may be attracted. Similarly, given the abundance of raw fruits, agro/fruit processing is also an area that could attract investment.

On a larger scale, the hydroelectric potential sector on both sides of the LoC could attract investment given the energy hunger that exists in India and Pakistan. However due to the capital intensive nature of this industry, a greater capital mobilization is needed to tap this potential source of wealth.

Tourism, which is already big in LoC-East and fast expanding in LoC-West, is still far from reaching its full potential and therefore is a prime candidate for investor attention.

LoC West

- Proven mineral reserves are around 157 million tons (Rs 70 Billion), which may reach up to 264 million tons with the addition of probable reserves. Minerals include Rubies and other semi-precious stones.
- 42% of the area is covered forest, which provides an advantage from a global perspective because these could be used as a source of carbon credits to trade.
- Tourism potential in AJK is a corollary of the state's nature-and heritage-based attractions.
- The region has the potential to generate 5,000 MW of electricity using its natural resources.
- Tax incentives to promote value adding industry.

LoC East

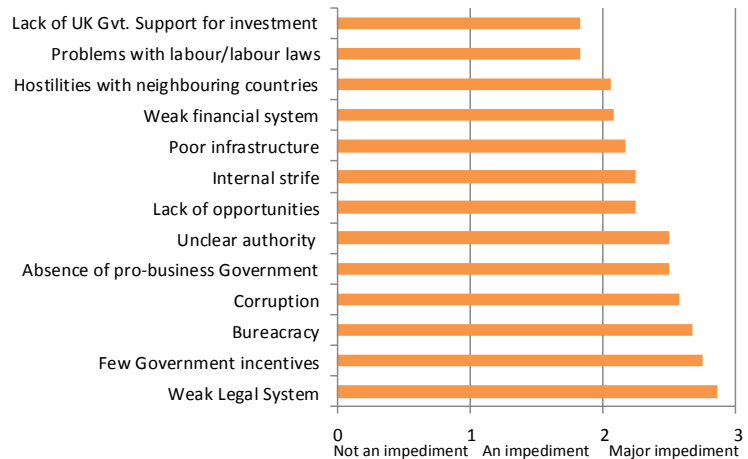
- Large numbers of pilgrims and tourists visiting Katra and the Kashmir Valley. There are not many services for these visitors.
- Eco-tourism declared a 'thrust area', where concessions and subsidies may be obtained.
- Exploitable minerals include Limestone and Gypsum.
- Hydroelectric power is potentially the most attractive destination for investment in LoC-East. Hydroelectric potential is estimated at 20,000 MW.
- Agriculture is difficult due to absence of regulation and formal institutions. Horticulture however, is considerably developed with 325,134 ha producing.

Role of the Diaspora

With the Kashmiri diaspora being well spread, with over 800,000 living in the U.K alone, the remittances to their families in Kashmir remain high. Although these funds are used mainly for consumption, the diaspora could be motivated to invest in the region for the social change that could bring.

However the diaspora still holds negative perceptions of business in Kashmir (as detailed in the chart on the right), that ward against any inclination to invest in the region.

UK Diaspora's perceptions on economic impediments in Kashmir (Survey)



Economically, the rejuvenation of the private sector is seen as a primary component of peacebuilding in countries making the transition from war to peace. Failed growth is regarded as having dire consequences, and the investment of capital and know-how seen as essential to serving as a bulwark against a return to violence.

Negative perceptions about security and the earlier opaque regulatory regime still remain in the minds of investors. The key in shaking off these perceptions is for the government on either side to take the initiative and align the state's policies with its economic advantages, thus creating an environment that promotes entrepreneurship.

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Chapter I: Introduction

Prelude

The disconnect between regions of the state of Jammu and Kashmir, which has continued over the course of six decades, has had a profound impact on the political economy of the local population on either side of the divide. Primarily, it has meant the closure of the natural routes and structures of economic engagement within the state and in parts, with the¹ neighbourhood.

Economic growth in the regions on either side of the divide remained stalled amid recurrent conflict and a situation characterised as 'no war, no peace'.² It has also affected the indigenous capacity to enlarge production, with or without assistance from abroad.

Repercussions of the unresolved situation continue to tell on the everyday lives of the population, with no gain for any of the competing powers. However, the promise of a qualitative upturn now rests on a paradigm shift in the ensuing peace process.

The prolonged conflict over Kashmir has reached an impasse because the stakeholders are unable to use traditional tools to project their positions and resolve the situation to the exclusive advantage of either. This has given way to a search for new thinking or to the notion of 'making the borders irrelevant': softening the Line of Control (LoC) instead of redrawing the borders.³

Context

It has become increasingly important to find and promote multiple connectivity – in terms of the movement of people, goods and investment – among people across the divides, and to turn this into an effective instrument of conflict transformation and stabilisation in the conflict-prone region. This endeavour should enlarge the stakes of the local population in the peace process and thus make it irreversible.

A number of studies have looked at cross-LoC travel and trade and other commercial links, and considered the use of educational assets to promote peacebuilding across the divide. This report explores investment potential as another instrument of conflict transformation.

Framework

The study proceeds on an assumption that trade alone is not a sufficient and reliable means of economic re-engagement of people across the LoC in the erstwhile state. First, intra-Kashmir trade, if not backed up by other tools, will face

the constraints of a small market (about 18 million people)⁴ and will not be in a position to mobilise great change. Second, an important dissuasive factor relates to the limitations imposed by short select lists of tradable goods and commodities that are unilaterally drawn from Delhi and Islamabad (not necessarily reflecting the market dynamism within Jammu and Kashmir).⁵ Economic rejuvenation would be helped if, along with a redesigned trade regime, policy makers and associated individuals promoted entrepreneurship and capital investment as new drivers in the stabilisation process.

The Kashmiri diaspora is the most potent constituency that has the resources and inclination to promote investment across the LoC in Jammu and Kashmir, provided that India and Pakistan provide sustainability to the peace process. The vast amount in remittances that the diaspora has sent back to Jammu and Kashmir illustrate both potential and inclination to engage economically.

Greater trust in the investment climate and flow of information would make it possible to channel these resources into entrepreneurship and capital investment within the regions of Jammu and Kashmir and across the LoC.

The decades of unresolved conflict and the militarisation that has followed have deterred capital investment on either side of the divide and prevented economic growth. Indeed, demilitarisation would allow intra-Kashmir trade and any move beyond trade towards investment to achieve their best results.

The disconnect between the two parts of the state has also prevented wider and more vibrant economic activity in the region. It has instead led to the greater dependency⁶ on India and Pakistan and 'artificial respiratory mechanisms'. Intra-Kashmir trade supplemented by investment would bring the possibility of long-lasting economic activity and therefore greater stability.

Trade alone would have only a limited impact because of its size and the absence of 'native ownership' of the process. It seems to have become one more channel for broader India-Pakistan trade, run by 'proxy traders' in a tariff-free environment.⁷

One can perceptibly remove barriers to trade from within the state for all products of state origin (except items which the parties have agreed to place on a negative list) and use this very trade-specific factor as the *raison d'être* to promote greater investment on either side of the divide.

Cross-LoC investment should be a mutually enriching venture for all concerned parties across the divide in Jammu and Kashmir, rather than generating fears of capital flight from one region to the other. The investments can presuppose a strengthening of the investment base on one side of the divide first before making mutually rewarding exchanges. Therefore, investments on either side of the divide should not be seen as synonymous with flight of capital and brain drain. Instead it should give the image of equal benefits and sharing of expertise and factors in production.

Segments and tools

The separate development of the two sub-regions over the past six decades, differing monetary and

fiscal policies, and exclusive tax regimes, mean that business is different on either side of the LoC. Moreover, the regulatory regimes on either side have their own distinct characters. The present study takes all of this into account.

The study draws extensively on meetings and round-table discussions with a variety of groups and individuals on both sides of the divide, and in the UK, which include policy officials, business leaders and academics. It also draws on surveys to gauge the views of the diaspora.

The sections of the study that deal with business and investment potential are addressed in the following chapters. The subsequent assessment carried in the last section is a joint product leading up to recommendations.

Chapter II: Business climate in LoC-West: The nature of the market, industries and regulatory regime

The region

LoC-West, otherwise described as the region of Azad Jammu and Kashmir (AJK) has an 'affiliate' status in Pakistan, unlike the constituent federating units, as a continuing legacy of the 1947 divide of the erstwhile state of Jammu and Kashmir.⁸ Its politico-administrative structure is a two-tier legislature: the AJK Assembly and regional administration in Muzaffarabad; and the AJK Council, a second chamber that is designed for co-management with Islamabad on subjects listed for the purpose.

For example, Islamabad controls monetary policy, including banking and currency, and some fiscal policy issues, as well as defence and foreign relations. Taxation of Pakistani Parliament does not *ipso facto* apply on the territory. Nonetheless, policies made in Islamabad have a profound impact on business in the region.

The region is a narrow strip of land with an area of 13,297 km² and a population of 4 million in 2011 (population density 305 people per km²).⁹ In geographic terms, it zigzags through river valleys that provide natural access to Jammu and Kashmir's historic links with the Indus river basin.

More than 60 years of division and conflict mean that this location has not achieved its full potential in contributing to the region's economic growth and rejuvenation. At the same time, however, it has intensified connections with the neighbouring market of Pakistan and promoted migratory trends.¹⁰ An estimated 236,371¹¹ Kashmiris live in

Pakistan, and almost 800,000 in the United Kingdom and Europe.¹²

Economic profile

AJK GDP was estimated at \$3.2 billion in 2011: 1.5 per cent of Pakistan's GDP¹³ (compared with the GDP of Jammu and Kashmir, which was estimated at \$10.4 billion in the same period). A precise economic profiling of the region, however, runs into difficulty in the absence of an official economic survey. In the estimated sectoral share, services dominate the economy, followed by agriculture, whereas industry takes a backstage.¹⁴ In keeping with trends in Pakistan's economy, the region's per capita income stands at \$1372¹⁵ and the current inflation rate at 11.3 per cent¹⁶.

The region's economic profile is dominated by land scarcity (42.6 per cent is forested and only 13 per cent cultivable), rich human resources (the literacy rate is 64 per cent) and an outflow of the population to job markets in neighbouring countries and further abroad. Nonetheless, infrastructure, including electricity and road communication (with a total of 9816 km of metalled and fair-weather roads)¹⁷ has improved significantly when compared with the late 1940s. Above all, the region maintains a good level of law and order conducive for business.

Tax regime

The region's tax regime is based around two legislative lists: firstly, the AJK Assembly, which exercises authority over health, education, provision of drinking water, rural and inter-

district road communication, electrification and population welfare; and secondly, the AJK Council, which controls about 42 areas including banking infrastructure, hydropower generation, exploration of minerals, tourism, the stock exchange and telecommunications.¹⁸ However, tax revenue, in the main, is collected by the Council and disbursed to the administration in Muzaffarabad, after retaining 20 per cent of the income tax segment.

The overall revenue (in terms of the AJK Assembly and Council budgets combined) comes to Rs. 24.6 billion¹⁹, in addition to around Rs. 11.4 billion received from Islamabad as a share of federal taxes. The revenue components are income tax (38 per cent of the total), sales tax (9.3 per cent), excise duty (4.8 per cent), professional direct taxes (0.16 per cent), motor vehicle-related taxes (0.4 per cent), and other minor taxes.²⁰ The taxation rates, particularly for income tax and sales tax, are adopted in AJK in tandem with the tax regime in Pakistan.

The AJK Council's share of income tax (20 per cent of the collection) is high when compared with charges that the federal government retains on behalf of Pakistani provinces (about 2 per cent) on account of administrative charges for tax collection. Concurrently, the Council has had exclusive control over revenue collected from mobile/internet providers for the past seven years.²¹ This entails \$45 million in licence fees and \$200 million in renewal charges per annum. (This data is not included in the overall revenue mentioned above.)²²

Moreover, the Pakistan Water and Power Development Authority (WAPDA) does not pay any sales tax to the administration in Muzaffarabad for Mangla power sales.

Until recently, a tax holiday on investments for an initial period of five years could be applied to sales tax and general sales tax. However, no such facility is available in the current setting.

Banking

Infrastructure

Banking infrastructure in AJK is an extension of the Pakistani banking system as supervised and regulated by the State Bank of Pakistan. The State Bank maintains representation in Muzaffarabad. All key Pakistani banks and some foreign banks have branches in the region.

The territory houses 27 banks with 441 outlets, including 2 non-Pakistani banks.²³ In terms of infrastructure, the Bank of Azad Jammu and Kashmir (48 branches), National Bank of Pakistan (88), United Bank Limited (76), Allied Bank Limited (53) and Habib Bank Limited (85) are among the

leading market shareholders. The distribution of banks in this predominantly rural setting is one branch per 30 km².

The data for 2011 suggests that the bulk of deposits have been made in Mirpur district. It is estimated that AJK residents, especially the business elite, also maintain substantial banking assets in the Pakistani provinces.²⁴

Notwithstanding the above, the data does not reflect the banking deposits held by the diaspora in the UK and the Middle East.

Deposits

The total amount of deposits in AJK is Rs. 181 billion held by 1.3 million depositors according to data published by the State Bank of Pakistan.²⁵ Further to this, it is estimated that an additional Rs. 200 billion have been deposited with the National Savings and post offices within AJK.²⁶ The region's scheduled banks showed annual growth of 3.1 per cent in deposits and 0.2 per cent in advances for 2011/12.²⁷ This surpasses Khyber Pakhtunkhwa (KPK) province, which has a population of 26.8 million.²⁸

Lending

With regard to the AJK formal financial sector, most branches of commercial banks mainly serve as deposit-receiving institutions and provide limited lending opportunities to the commercial sector; thus, their loan portfolio is quite limited. Total estimated lending in 2011 amounted to Rs. 10.3 billion to 48,129 creditors including agriculture and livestock (Rs. 0.6 billion), SME loans (Rs. 2.4 billion) and others (Rs. 7.3 billion)²⁹.

Lending in 2011 accounted for 5.7 per cent of the total deposits held by the banks. Concurrently, the lending portfolio of the region witnessed a mere rise of 0.2 per cent in advances compared to the previous year. Perceived difficulties and complaints of lenders related to lending facilities persist³⁰ amid lucrative amounts of deposits, rooted in the region's diaspora, and the banking sector's quest for security on returns. (Conversely, the investment policy in LoC-East stipulates mandatory minimum investments equal to 15 per cent of the deposits.)

Remittances

The remittances from the Kashmiri diaspora to AJK remain strong, as well as links with the diaspora in other domains. Various sources carry a near-unanimity that this remittance intake is disproportionately higher than expected for the population of the region, and yet there is no firm data on the actual remittances arriving in the territory.

Although the population of the region is less than 2 per cent of the population of Pakistan, 6.25 per cent of funds remitted by overseas Pakistanis go to AJK.³¹ Remittances sent by official channels to Pakistan were \$10.9 billion in 2011-12,³² of which an estimated \$ 0.7 billion came from the Kashmiri diaspora. A sampling of remittances from UK may also be relevant for a better understanding of the potential.

Remittances from the UK to Pakistan between June 2011 and February 2012 amounted to \$ 0.14 billion³³. Multiple sources in the business arena share the view that 30 per cent of this originates from the Kashmiri diaspora.³⁴ Besides the problem of mapping remittances through official channels, quantifying funds arriving through informal channels poses no less a problem.

Notwithstanding the use of the remittances for investments, the flow of funds from the diaspora has had a profound impact on the household economy of the region. A social survey of AJK in 1992 estimated non-agricultural income to be 29.7 per cent, of which 44 per cent was remittances.³⁵ A recent case study illustrates how the majority of the funds are used for consumptive rather than productive uses.³⁶

Insurance

The insurance laws and policies of Pakistan are adopted in AJK.³⁷ Some of the eminent insurance companies³⁸ in the Pakistani market are operating in the region.

Trade

The market in AJK is interwoven with the neighbouring markets of Pakistani provinces, making this, for all practical purposes a 'free trade area'. There is no register or stock entry of trade flows and therefore no reliable figures are available. Customs duty between AJK and Pakistani provinces was formally lifted in the 1950s.

Cross-LoC trade is a newer phenomenon providing limited openings. This trade amounted to \$211 million in 2010, equivalent to 2.2 per cent of AJK GDP (or 0.7 per cent of Jammu and Kashmir's GDP).³⁹ However, 'proxy' traders essentially drove this trade and therefore its impact on the economic rejuvenation of the region remains uncertain.

A window on the existing entrepreneurship

The existing industrial scene ought to be viewed with reference to mineral exploration (still in search of downstream industry), horticulture (minor industry) and value-adding ventures (which have emerged on various industrial estates).

Furthermore, hydroelectric power retains high potential in terms of growth in investments, whether public or private sector.

The industrial estates are, in the main, in Mirpur and Bhimbher districts, which are near Pakistani markets and therefore regarded as suitable for medium and large-scale industrial ventures. However, some opportunities for small and medium industries are also available in districts, namely Poonch and Muzaffarabad.

Regulatory regime and various stakeholders

The regulatory regime covering entrepreneurship in AJK reflects the two-tier makeup of the region. The Industries Department and Hydroelectric Power Board act as the main regulatory authority and the registration process is undertaken by the Companies Registrar in Muzaffarabad. Simultaneously, subjects that fall under the jurisdiction of the AJK Council are dealt with through specialised bodies in Pakistan (eg NEPRA, PEMRA, PTA, etc), under ad hoc agency-relationship agreements with these Pakistani bodies.

The adoption of Pakistani laws by the AJK administration, together with the in-built diarchy in the regulatory regime carries with it operational complexities. When mega-projects⁴⁰ come about, there is an extra-legal influence of Pakistani institutions operationally. The State Bank of Pakistan, while acting as a guarantor of foreign investments, works in collaboration with the AJK government/Council and international lending agencies, while keeping in view the guarantees of the government of Pakistan. Nevertheless, investment protection laws are the same as those in neighbouring Pakistani provinces.

In terms of hydroelectric power mega-projects, informal arrangements, rather than laws govern the division of labour. In this context, it is assumed that the AJK government regulates projects up to 50 MW, and Islamabad and the Private Power and Infrastructure Board regulate projects above this capacity. The AJK Council acts on behalf of the AJK government in the latter type of project.

The region does not have an investment promotion board that could provide a one-stop shop for information, further services and to serve as a vehicle to set the pace and direction of activity from the policy-relevant umbrellas to the private sector. (A blueprint for the Board was drawn up by the AJK government but without any significant progress).

Multiple entities in the public sector that provide potential links for the private sector are: Mineral Developmental Cooperation (AKMIDC); Logging and

Saw Mills Cooperation (LMC), currently dormant; Small Industries Cooperation; the Horticulture and Agriculture Department; and Department of Industries (which also serves as regulator for industrial ventures on behalf of the Muzaffarabad administration); Tourism Department; and AJK Hydroelectric Power Board.

These entities can provide the policy framework and master plans for downstream action in the relevant industries and sectors. Various trade syndicates represent private sector interests in trading and entrepreneurship, among which the AJK Chambers of Commerce and Industry is an important institution.

Appraisal

The region's business environment carries a number of positive ingredients, the foremost

being the rich human resources in terms of skills and resource mobilisation abroad, and natural resources including water that hold the promise for an upturn in capacity, investment and revenue. The region continues to be identified with a very high level of remittances from its diaspora, wide banking infrastructure and deposits, even though lending remains an unresolved technical issue. Moreover, these factors are reinforced by relative peace that is conducive for business activity.

The mapping of economic potential and periodic economic survey, together with a high -profile marketing campaign is needed to bring a spotlight on the opportunities that do exist in this region. However, better utilisation of the region's potential will only be possible when the political system overcomes or looks beyond the current diarchy of the political system and speeds up decision-making process.

Chapter III: Business climate in LoC-East: The nature of the market, industries and regulatory regime

The region

Jammu and Kashmir on the Indian side (interchangeably called LoC-East) is categorised as a state of the Union⁴¹. However, unlike all other states, the power of the Indian parliament to make laws with respect to the LoC-East is circumscribed by the provisions of Article 370 of the Indian Constitution. Indeed, the state of Jammu and Kashmir is the only one to have its own constitution, which was adopted in 1956⁴². However, for all practical purposes the structure of governance in the state is not substantially different from that of the other states of the Union.

In most matters, the Legislature of Jammu and Kashmir has kept on extending various Indian laws to the state ensuring uniformity of administration. In the post-liberalisation era, with the Indian central government loosening its grip over many economic issues, the states are now largely coming into their own, to the extent that their public finances will allow. However, given the precarious nature of the finances of most state governments – with LoC-East being no exception – the central government still has considerable leverage given the scale of discretionary grants at its disposal.

The policies of the central government, of course, make themselves felt through areas that are under Delhi's control according to the Union List, including defence, foreign affairs, monetary policy including banking and currency, certain fiscal policy issues and so forth. Even the taxation regime adopted by

the central government is applicable to Jammu and Kashmir, and deviations thereof are by way of central government largesse and not the powers of the state government. Thus, central government policies have a large impact on the investment climate of the state.

The LoC-East has an area of 101,387 km² and a population of 12,548,925, according to the 2011 census.⁴³ Administratively, LoC-East is separated into two Divisions: Kashmir Division that comprises the Valley districts as well as Leh and Kargil districts in Ladakh; and Jammu Division that comprises the districts of the Chenab Basin, the Pir Panjal Districts, Udhampur, Jammu, Samba and Kathua. The area of the Kashmir Valley is 15,948 km², with a population of 6,907,622. The area of Ladakh is 59,146 km², with a population of 290,492. The area of Jammu is 26,293 km², with a population of 5,350,811⁴⁴.

Economic Profile

The Gross State Domestic Product (GSDP) of LoC-East in Financial Year 2012/13 was estimated at \$15.2 billion in 2011 (Rs. 76,115 crores), which showed a 7 per cent growth on the previous year. The economy is dominated by services (54.89 per cent), followed by industry (24.55 per cent) and agriculture (20.56 per cent)⁴⁵.

Agriculture in Jammu and Kashmir has been characterised by low productivity for the most part. Although the State has been a dominant

producer of certain products like apples and other fruits, productivity has remained low. Given the terrain, high costs have inhibited industry. LoC-East – that part of the former Princely State of Jammu and Kashmir that is administered by India – is a mountainous state. Therefore, like all hill economies, it is a high-cost economy.

Any enterprise that is set up in LoC-East has to deal with the high costs of transportation, given its distance from the main markets from India, and also the mountain roads, which take a heavy toll on vehicles, as well as resulting in hefty fuel bills. This is an inevitable feature of any hill economy and LoC-East is no exception. In the absence of any substantial mineral deposits or other resources that can aid industrialisation, hill economies on their own cannot be expected to attract industries.

However, given the topography and extensive water bodies, the hydroelectric potential of the state is very high and is estimated at being capable of generating about 20,000 MW. However, hydroelectric power projects are extremely capital intensive, and resource-strapped states with few entrepreneurs capable of raising resources of the required magnitude cannot be expected to tap this potential source of wealth.

Thus at the time of independence and at the beginning of the planning period, LoC-East had very little industry. Apart from its geographical features, the peculiar political development of this state ensured that it was not integrated with the larger sub-continental market, except for a few commodities – such as apples, of which it remains the largest producer. Like the rest of the sub-continental economy, and indeed more so, it was largely an agrarian economy, with a very small industrial base restricted to handicrafts supplemented by silk mills owned by the state.

The industrialisation that LoC-East saw after 1947 was on account of a dirigiste central government that directly regulated industrialisation through licences and permits rather than indirectly through taxes and subsidies in a market-driven economy.

For this reason, the Birla family set up the Chenab Textile Mills (which manufactures cotton yarn) in 1962 in Kathua, the southernmost district of the state, otherwise a most unlikely location for such factory. Similarly, the Public Sector Undertaking Hindustan Machine Tools set up a unit in Srinagar, though there were no discernible advantages in setting up a unit there.

In this way, the planning process adopted by the Indian government set up the rudiments of an industrial sector, which did not reflect LoC-East's

own strengths or entrepreneurial prowess. Indeed, as much as the planning policies were responsible for the industrialisation of the state such as it was until 1991, it could also be said to have been equally responsible for such a low level of industrialisation. This is because the method of licenses and permits to govern investments ensured that the price mechanism via the market was circumscribed in influencing investment decisions. This prevented any industrialisation based on the factor endowments that the state possessed.

For example, industries based on fruit processing could have easily developed in LoC-East given the abundance of certain types of raw fruit like apple. Similarly, the availability of gypsum could have given rise to a sizeable cement industry (as is currently happening.) But this was not to be. After militancy in the state was curbed to some extent, the government of India and the state government in LoC-East rolled out various sops⁴⁶ to attract industry to the state. These included 10-year tax holidays from excise duties, generous capital subsidies, and subsidies on captive power generation, which led to some investors setting up industrial units in the state.

Previously, tourism dominated the services sector. After the onset of militancy, tourism arrivals to Kashmir were badly affected, but arrivals in Jammu rose, particularly the numbers of visitors to the Shrine of Shree Mata Vaishno Devi in Katra. Their numbers are now more than 10 million. In the past few years, tourist arrivals in Kashmir have also broken all previous records. But the services industry had other drivers as well. The large presence of security personnel and then big infrastructural projects ensured that other services also got a boost in the state.

Public finance and tax regime

Jammu and Kashmir is one of the 11 'Special Category states' and thus eligible for a variety of concessions when it comes to assistance from Delhi. These include significant excise duty concessions to attract industry. In the realm of public finances, when it comes to Plan Assistance (funding of schemes as approved by the Planning Commission of India), the disbursement to special category states is in the form of 90 per cent grant and 10 per cent loan. For the other states it is 30 per cent grant and 70 per cent loan. Thus, the incentive for such states to raise their own revenue is low, as table 1 reveals.

Out of total revenue receipts of Rs. 33,970 crores, the Jammu and Kashmir state government's own revenues are Rs. 9,733 crores, less than one-third. The central government grants are Rs. 19,752

crores, which is slightly less than 60 per cent of the total revenue receipts. Its share of central taxes is Rs. 4,485 crores. This underscores the dependency of the state government on the central government.

The non-tax revenue raised by the state government (Rs. 3,033 crores) is dominated by the revenues raised by the state Power Development Department from electricity users. However, the amount spent by the state in buying this power is substantially more than the receipts from sales of this power, which is one of the main reasons for the state government budget deficit.

This ensures that the state is not able to spend as much on infrastructure like roads as is desirable. The extent of LoC-East borrowing is limited by the *Jammu and Kashmir Fiscal Responsibility and Budget Management (FRBM) Act, 2006*, a rule-based fiscal framework whereby the state is committed to reducing the debt: GSDP ratio from 56.1 per cent in 2010/11 to 49.3 per cent in 2014/15.

Banking

Banking and indeed financial institutions in LoC-East are subject to the supervision and control of the Reserve Bank of India.

The banking sector in Jammu and Kashmir is dominated by the Jammu and Kashmir Bank (JK Bank), which is in the private sector but with the state government as the largest shareholder. The total number of bank branches in the state is 1302 (2011-12), of which: 332 belong to public sector banks; 463 to private sector banks (dominated by JK Bank); 287 to regional rural banks (supported

by the National Bank for Agriculture and Rural Development); and 220 belong to banking cooperatives.

A little over half these branches are located in rural settings, and the remainder are spread evenly over urban and semi-urban areas. The total deposits in the banking system are Rs. 55144 crores (2012-13), and credit advanced by these branches is Rs. 18,949 crores (ie a credit:deposit ratio of 34.36 per cent). This is a fall from the credit:deposit ratio of the previous year of 35.57 per cent.⁴⁷

A district-wide analysis of credit disbursals suggests that apart from industry, credit to horticulture (primarily apples) and saffron growers is significant.

The Central government stipulates that a target of 40 per cent of adjusted net bank credit (ANBC) or credit-equivalent amount of off balance sheet exposures (OBE) – whichever is higher on 31 March of the previous year – has to be devoted to certain sectors specified as priority sectors. Although the performance in agriculture and housing is as targeted, the credit advanced to education, small enterprises and micro-credit is still below the target, with those sectors receiving less. All this shows that entrepreneurship in LoC-East has still not taken off.

Insurance

The insurance laws and policies in LoC-East are governed by central legislation and the state's insurance market, like that of other states, is competitive, with both public and private sector insurance companies present.

Table 1. Revenue receipts of the state government of LoC-East

Items	2011-12 (Actuals)	2012-13 (BE)	2012-14 (RE)	2013-14 (BE)
Revenue Receipts (I+II)	24783	29948	29499	33970
I. Resources from Centre	18036	22471	20705	24237
i. Share of Central Taxes	3495	4245	4085	4485
ii. Total Grants from Centre (a+b)	14541	18166	16620	19752*
a. Non-Plan Grants, of which	4551	4496	4740	4102
i. Others	4030	3852	4797	3430
ii. SRE nd Cost Sharing	521	644	643	672
b. Plan Grants and including CSS	9990	13670	11880	15650
II. State's Own Revenues (1+2)	6747	7537	8794	9733
1. State's Own Tax Revenues	4745	5419	5975	6700
a. Sales Tax	3414	3940	4219	4799
b. Excise Duty	385	404	413	423
c. Others	946	1075	1343	1478
2. Non-Tax Revenues, of which	2002	2118	2919	3033
<i>Interest Receipts</i>	33	20	22	21

* This figure is tentative as the Scheme of Financing AP 2013-14 is yet to be approved by the Planning.

Trade

The markets of LoC-East and the rest of India are integrated, with LoC-East collecting octroi at the entry point to the state at Lakhanpur. The laws that govern trade in LoC-East are generally harmonised with Indian government laws.

Local entrepreneurship

Agriculture in Jammu and Kashmir has been subject to comprehensive land reforms. Thus, there are few large landholders in the state. There are some areas where capitalist farming (operations carried out with the help of wage labour) is practised, but it is rare and agriculture surpluses are low. Orchard management on the other hand has not been subject to land redistribution to the degree that agricultural land has been. Thus, the degree of capitalist farming has been greater and considerable surpluses generated on this account.

However, the lack of local initiative is demonstrated by the absence of any move to add value to horticultural produce. Instead, industrial units are devoted to the production of such goods that can be produced more efficiently elsewhere and exist in the state only to benefit from excise duty concessions. Thus, there are industrial hubs in Kathua, Samba, Gangyal, Udampur (in Jammu Division), Khanmoh, Rangreth and Shalteng (in Kashmir). Whether they would exist without the generous sops extended to them by the state government is a question that deserves investigation.

Since 2005, the spree of construction that the state has witnessed has given rise to several cement plants, largely in Khrew, aided by the fact that gypsum is locally available. It is likely that these industries would survive even if subsidies and tax holidays were withdrawn.

Services, in so far as tourism is concerned, are dominated by local businesspeople. This is not because the regulatory regime bars outsiders, but largely because perceptions about security and the earlier opaque regulatory regime have meant that outsiders preferred to stay away. When compared with other states, professionalism in this sector in LoC-East is below par. Services such as banking and insurance are dominated by big players, with the only local player being the LoC-owned JK Bank.

The regulatory regime

Post-liberalisation, when it comes to regulatory regimes, each state is responsible for the entrepreneurial climate obtained there. This is also true for LoC-East. There are, of course, some extraneous factors that are present here relating to security. But the regulatory framework and the ease

with which business people can do business in LoC-East largely depend on the government of LoC-East.

If one goes by quantitative gauges that measure economic freedom, Jammu and Kashmir has been steadily improving. Its rank has risen from 15th out of 20 states in 2005 to 7th in 2011⁴⁸. This implies that the state government has been doing away with red tape and unnecessary formalities that confront economic agents wherever possible.

However, the problems of being a high-cost economy still remain. The road network of the state compares poorly with the neighbouring hill state Himachal Pradesh. This is a major problem because most of the plots in the industrial estates where infrastructure is needed for industrialisation in concentrated areas have already been acquired.

Where power is concerned, the consequences of dirigiste policy make themselves felt by making investment in industry less profitable than it should be. LoC-East spends much more on buying power than it receives selling the same power to consumers. It has long tried to reduce this deficit by cross-subsidisation where industry pays much more than other consumers. Until this problem is tackled, industrial growth will be hampered. Other commercial establishments such as hotels have to rely on captive power generation, which drives up costs.

The state's hydroelectric resources will never be properly exploited until LoC-East modifies its stance about the state government reserving the right to purchase power generated by any power producer in the state. Given the precarious nature of the state government's finances, few financial institutions will arrange for loans to any producer that wished to invest in power in LoC-East. Thus, the state's power policy curbs its long-term growth prospects, as well as creating a massive hole in its budget in the short term.

But when it comes to regulation, the state is as open for business as any state in India. Even land that state regulations prevent non-permanent residents from acquiring can be had on a 99-year lease for commercial purposes. Today, foreign direct investment from Pakistan is also allowed into India, and therefore into LoC-East, except in a few sectors related to defence.

Appraisal

As stated, LoC-East begins with a handicap: it is a high cost economy because of its terrain and must therefore have a business plan that takes this handicap into consideration and neutralises it. The licence-permit Raj that governed the Indian

economy until 1991 and the militant violence that was finally curbed in late 1990s prevented the rise of such a plan, because this could only arise from private entrepreneurs, with the state playing the part of the enabler.

Entrepreneurial skills that exist within and without can exploit the state's potential, provided that the state government provides an enabling environment and security is ensured. Thus, governance and security are crucial if the peace dividend is to be harvested. In some cases, domestic entrepreneurial skills have already been demonstrated.

The Kashmiri artisans turned the crisis of the 1990s into an opportunity when they spread out

throughout India to market their wares. In contrast to industrialists who came to take advantage of the excise duty concessions, they received very little financial aid from the government. Paradoxically, these artisans are more integrated with the global economy than the industrialists who could not compete with the rest of the world had it not been for the generous subsidies made available to them by the state government.

The key in LoC-East therefore is to align government policies with the advantages that the state possesses, to tone up governance and to create an environment where entrepreneurs within and without can participate and create wealth in LoC-East to the benefit of all concerned.

Chapter IV: The investment potential and entrepreneurial class in LoC-West

Prelude

The region's investment potential, though constrained by its size and geography, is in natural, water flows and rich human resources in terms of their skills and resource-generation abroad. The potential is enforced by multiple factors including law and order conducive to business (and the lowest crime rate out of the Pakistani provinces), communications networks (roads and telecommunications) and basic infrastructure (electricity coverage, water availability). Remittances from abroad, regardless of the end uses, remain high and serve as a reminder of the future economic direction. Together, these factors underpin business in the region.

The investment potential of the region is represented in multiple sectors: mineral wealth; forestry; horticulture/agriculture; tourism; hydroelectric power; and value-added industrial

potential. A more comprehensive discussion follows in the subsequent paragraphs.

Mineral-based potential

AJK has proven mineral reserves worth Rs. 70 billion. The total proven reserves are around 157 million tons, which may reach up to 264 million tons with the addition of probable reserves. Table 2 shows the major metallic minerals estimated in the year 2011. A comparison between the proven and probable reserves is detailed in the annex.

Currently various minerals mined include precious (ruby) and semi-precious stones (tourmaline, etc), coal, marble, bentonite and dolomite (mined on small scale). Nevertheless, the mining sector is confined to a very small scale and contributes less than 1 per cent to the total GDP.⁴⁹

The mineral deposits established as viable⁵⁰ for commercial exploitation, despite their disadvantageous location, are rubies and other semi-precious stones (tourmaline, spessartine, etc), graphite, bentonite, cement material and limonite. However, exploitation of these minerals is either limited to small-scale and local uses or, in the case of precious stones, geared to export because of the lack of local processing facilities. The industry has the potential to grow if minerals-processing facilities are established in the region.

A study on Nangimali Ruby, now marketed internationally as 'Kashmir Ruby', revealed that, after taking two years to establish itself, a mine could potentially produce 300kg of rubies per year. This would entail an estimated investment of Rs. 112 million only.⁵¹

Table 2. Mineral deposits in AJK

Mineral	Total Reserves (Million Tons)
Llme Stone	100
Marble	34
Coal	30
Granite	15
Bauxite	7
Quartzite	7
Gypsum	5
Dolomite	3
Graphite	1
Ruby	44 (million grams)

Source AKMIDG

A number of pre-feasibility studies have focused on mineral-based industries. Limestone/shale (with reserves of about 100 million tons) and gypsum (about 4 million tons) are located within a 10-km radius of Muzaffarabad city. Pre-feasibility studies covering reserve potential and suitability of materials for cement manufacture are available. The estimated investment required for establishing a cement plant with a 2000-ton per day capacity is Rs. 3 billion.

Feasibility studies are also available for the exploitation and processing of graphite (Rs. 67 million), and mining and processing bentonite (about 25 tons of bentonite per day for an initial investment of Rs. 93 million), besides quarry development for granite, and marble cutting and polishing in the Muzaffarabad region.

The mineral industry has immense potential for contributing to AJK's GDP growth. Investments in mining and processing of minerals can earn lucrative capital. Nevertheless, the state government lacks the requisite capacity to invest in the mineral industry. Against this backdrop, public-private partnership or exclusive private investments are the prospective business strategies.

Forestry, horticulture/agriculture-based opportunities

The region is in a dry temperate zone and has mixed subsistence farming, which includes crops, livestock, and horticulture and forestry activities. Generally, farms are owner operated and small, with an average land holding of 1.4 ha and a cultivated area of 0.7 ha. Farm productivity is constrained by small fragmented holdings, harsh climatic conditions, low-quality seeds, limited fertiliser use and poor pest and disease control. There are 72,800 ha of cultivated land, of which 6,200 ha are irrigated.⁵²

Although agriculture and livestock contribute up to 40 percent to local household incomes⁵³, cultivable land stands at almost 13 per cent and forests cover 42 per cent of the total geographical area.

Horticulture and conventional agriculture have immense potential if based on modern techniques of pest management and farming, supported by a small bank loan. Currently, there is no facility to demonstrate cultivation of fruit orchards or train vegetable growers. Hence, areas such as greenhouses, tunnel farming, fruit-processing, seasonal/off-seasonal British vegetable production and preservation/processing, floriculture and cut flowers, potato and vegetable seed production and so forth are to be developed according to their potential.⁵⁴

Production and marketing of cut flowers – in particular, gladioli, carnations and roses – is already underway. The total turnover of the gladioli business has reached more than Rs. 20 million⁵⁵. Farmers need financing, packing materials and transportation facilities, such as better infrastructure and vehicles, to enlarge their market.

Forests provide an advantage from a global perspective because these could be used as a source of carbon credits to trade. The current focus in forestry is on conservation, sustainable management and enhancement of carbon stock. However, 3Ds categories of trees (diseased or dead trees)⁵⁶ are transported via river systems to downstream markets. There is the potential to revive the former Logging and Saw Mills Cooperation and also link this with the furniture⁵⁷ industry, which has the potential to create revenue, especially from the rare Deodar segment of the 3Ds.

Tourism

Tourism potential in AJK is a corollary of the state's nature-and heritage-based attractions. First, the picturesque valleys provide all sorts of opportunities, including recreational and sightseeing activities, (eg the Jhelum and Neelam river valleys in Muzaffarabad and Poonch region, and Mangla reservoir in Mirpur).

The setting is ideal for adventure tourism, with a focus on hiking, trekking, rafting, paragliding and high-altitude climbing. Second, the region's beauty is supplemented by its historical and cultural heritage, which attracts a cross religious/spiritual clientele (eg Sharda Temple in Neelam Valley, Sikh holy sites in Muzaffarabad, and the shrine of Sahib-e-Saiful Muluk Mian Muhammad Bakhsh)⁵⁸. A third factor is the prospect of expatriate families returning home for holidays. A relative peace in the region and images of good law and order are encouraging.

After the ceasefire in 2003, tourism as an industry was revived in the Neelam Valley and Poonch region, with a growing tendency for investment and remodelling of houses to establish private guesthouses. For the expatriate community, this potential has evoked attraction for spending money from abroad and investing in such industries. This is evident from the fact that branches of major banks have established branches in even the lower villages of the region.

An estimated 500,000⁵⁹ tourists from neighbouring Pakistani provinces visited the Jhelum and Neelam river valleys of Muzaffarabad, and Poonch in 2012. It is therefore becoming increasingly relevant to promote and facilitate medium-scale private

investment in building guesthouses and restaurants in the area. The need for major hotel outlets is also on the cards. Concurrent with this, private sector investors would also be welcome in the domain of human resource development training (front desk management, cuisine and tour guides).

Transportation facilities are now open to private investment, especially quality bus services and possible investments in helicopter services and private tour-operating firms. The decision to re-open two airports at Muzaffarabad and Rawalakot, and to construct an international airport in Mirpur, is likely to advance the process.

Hydroelectric power

AJK is the conduit of northern waters to the Indus basin via the Jhelum, Neelum and Poonch rivers. The region's hydroelectric power generation potential is now coming to the fore as one of the most attractive business investments. In this context, it is opening up to private investment along with public.

The region has the potential to generate 5,000 MW⁶⁰ of electricity using its natural resources. Its indigenous demand is 400 MW, which is estimated to reach 1,000 MW only by 2025. The region's installed capacity is in three segments: Mangla Power, which produces 1,000 MW-1,200 MW (a major WAPDA project since the 1960s); six small-medium public sector projects, generating 40 MW combined (AJK HydralPower Board); and an 84-MW private sector hydroelectric project (Laraib Energy Ltd at Bong). These ventures primarily supply the Pakistani National Grid.

Hydroelectric power projects in the pipeline, for which the formalities have already been completed, hold the promise of an additional 812 MW in the coming years, of which 62 MW will come from the public sector and 750 MW from the private sector. Construction work has begun on 13 of 54 public and private sector projects in various parts of AJK.⁶¹ Concurrently, five major projects totalling 3,000 MW, including Azad Pattan (600 MW) and Dodnial (300 MW) have been short-listed for future investment. The size in terms of prospective investments can be explained by the rule of thumb in the current market that 1 MW costs US \$2.5 million.

Laraib's 84-MW New Bong Hydropower Project is the first independent hydropower project in the entire region and has already started commercial operations.⁶² This has set the precedent for upcoming foreign investments in the AJK energy sector. Hydroelectric power appears to be the mainstay of future investment growth in the region.

Value-added investment

Plans to increase investment in value-adding industries are based on importing goods from neighbouring markets and re-exporting them to the same markets. Six industrial estates have been established and investment is encouraged by providing opportunities for investors in the form of tax waivers and financial incentives for a fixed period of time. Land at cheap rates is also made readily available.⁶³ At their peak, there were up to 400 industrial units, which employed about 30,000 people. However, in the past five years many industries have left AJK because of controversy over tax exemption and non-cooperation of banks. Nevertheless, six industrial estates in various districts of AJK have been established: Bimbher (1 unit), Mirpur (2), Mangla (3), Dadhyal (4), Kotli (5), Rawalakot (1) and Muzaffarabad.⁶⁴ However, in the absence of factoring a larger strategy and non-availability of lending, local industrial productivity is affected.

Major industries in operation include: textiles, engineering, rickshaws and scooters, steel furnaces and mills, cigarettes, polyester yarn, chemical, pharmaceutical, poly-propylene bags, copper wire, cosmetics, rubber and plastics, marble, ghee and cooking oil.⁶⁵ The potential for value-added industry, though theoretically immense, is constrained by the fact that its pace is determined by fluctuations in the market in neighbouring provinces of Pakistan, and tax relief that is either offered or withdrawn by the AJK administration. Nonetheless, the stable growth of this segment of industry also depends on the access its products can get to the other side of the LoC.

Entrepreneurial class and potential

The entrepreneurial class in AJK derives its strength from diaspora remittances and the investments they have largely made in Pakistan. The investments are reflected in real estate (including the tallest structures in Islamabad) and a variety of industrial concerns in Punjab, KPK and Karachi. Regardless of their original heritage, entrepreneurs often have dual addresses, in the Pakistani provinces and AJK. A survey of the front-runners on this count is now underway.

The AJK Chambers of Commerce and Industry, with headquarters in Mirpur, represents businesses in AJK and has more than 5000 members. Besides this, a large number of trading syndicates, which represent region- or trade-specific interests, are also present. However, though benefitting from an impressive infrastructure, this platform is not yet poised to provide investment guidance and services to international investors and the diaspora.

The business network abroad needs to undertake capacity-building projects. Similarly, the government needs to accelerate the process of establishing its Board of Investment to serve as the main vehicle of coordination, and if possible for one-stop shops for potential investors.

Appraisal

The region remains a land of opportunities, whether untapped or half tapped. Its potential in multiple sectors continues to be a source of attraction for potential investments from abroad, particularly those from the diaspora. The major sectors of potential growth in the coming decade are hydroelectric power (linked with water flows); tourism (aided by its natural wealth and relative peace); and mineral-based processing and production of materials such as cement (once the heavy load-worthy road to Muzaffarabad has been completed, a major factor in the realisation of this potential avenue of investment).

Nevertheless, the value addition industry remains stagnant because it is contingent on importing ingredients from the neighbouring market and re-exporting goods there. It is likely to grow in the coming years if the cross-LoC trade moves beyond the confines of 20 or so items (minor fluctuations in the list occur year on year), and indigenous industrial production on both sides is allowed to grow and interact with the markets across the divide.

An obstruction to long-term growth has been the absence of economic mapping and surveys, leading to a regular lack of economic and commercial data; and the AJK administration's indecision, if not lack of vision, coupled with the diarchy of the political system. The region's economic growth will rapidly leap forward if these obstructions are removed to pave the way for greater investments. Public-private partnership will provide the engine for this growth.

Chapter V: The investment potential and entrepreneurial class in LoC-East

Prelude

As was mentioned above, LoC-East is a hill economy and thus investment potential is constrained by the disadvantages that affect such economies. However, nature has compensated LoC-East in many other ways, which if utilised can more than offset its disadvantages. Some of these gifts are being exploited already, whereas others are not.

The nature of the terrain in LoC-East and the limited spread of road and rail networks greatly inhibit the development of the region. However, the potential areas of investment in the state are numerous and the exploitable potential enormous. In this chapter we will concentrate on a few areas: hydroelectric power, tourism, horticulture, and the extractive industries.

The investment potential of the region is represented in multiple sectors: mineral wealth; forestry, horticulture/agriculture; tourism; hydroelectric power and value-added industrial potential.

Tourism

A remarkable fact about tourism in LoC-East is that the state government has no official tourism policy that sets out guidelines for operators in this sector to follow⁶⁶. Despite tourism taking off dramatically, which has led to a dire need to upgrade the existing tourist infrastructure, LoC-East is perhaps the only state government that does not have an official

tourism policy. This is simultaneously a drawback and an opportunity. The shortage of roads creates problems for the sector, but the shortage of hotels is clearly an opportunity for profitable investment.

LoC-East has three kinds of tourists: pilgrimage tourists who throng to the Shrine of Shree Mata Vaishno Devi in Katra located in Reasi District in Jammu Province; tourists who visit the Valley of Kashmir; and visitors to Ladakh.

The number of pilgrims who visit Katra now exceeds 10 million⁶⁷. However, most of these pilgrims do not extend their stay after visiting the shrine and choose to return home. Even if a small fraction of these tourists could be persuaded to visit Jammu, the revenues generated would be enormous. Debate in the hospitality sector seems to favour government intervention, when arguably it is entrepreneurship that has a greater role to play in this regard.

Similarly, tourism in the Valley of Kashmir (1.4 million visitors in 2012⁶⁸) is centred on Sonmarg, Pahalgam, Gulmarg and Srinagar. There has been no effort to divert tourists to rural Kashmir, even though in the peak season there are no rooms to be had in Srinagar. This is another example of an unexploited opportunity that requires entrepreneurship. Ladakh is still relatively virgin territory, where space exists for new entrants.

The tourism and hospitality sector in LoC-East is a fragmented sector with very few big players.

Although fast-food chains such as McDonalds' have entered the market, they are unlikely to be a game-changer in the local context. Some national brands where hotels are concerned have either invested directly or come in through the franchise route. But by and large, this sector remains dominated by locals, even though on paper there are few rules that discriminate against non-locals.

The absence of sector-specific professionalism/expertise in an area of such enormous potential indicates that investment in this sector will be rewarding. Although attempts have been made to attract investors with generous subsidies, only one segment of tourism – eco-tourism – has been declared a 'thrust area', where concessions on taxation and capital investment subsidies may be obtained⁶⁹. Otherwise, conventional tourism is deemed to be sufficiently profitable to be excluded from state assistance.

Extractive industries

LoC-East is not particularly known for an abundance of mineral deposits, largely because the attention of the Indian government in this regard has focused on states such as Bihar, Madhya Pradesh, Orissa and states where mineral wealth is more abundant. Table 3 illustrates LoC-East's mineral wealth⁷⁰:

It is clear that the exploitable mineral wealth supports industries such as cement manufacture. Indeed, there has already been private investment in this sector, with local entrepreneurs have been adding to capacity. The construction boom has encouraged this investment in recent years both in the private as well as the public sector (dominated by infrastructural spending on roads as well as rail). Moreover, given the trajectory of cement prices since 2004, it is likely that this sector will continue to be profitable, the high costs of transport notwithstanding.

Table 3. Mineral wealth of LoC-East

Mineral	Estimated reserves (mn= million)	Location of Deposits	Use
Limestone	5000mn tons	All districts except Doda, Jammu, Poonch	Manufacture of cement, calcium carbide
Gypsum	152mn tons	Baramula, Doda, Uri	Manufacture of cement, fertiliser, paint, rubber
Marble	405mn m ³	Kupwara	Decorative building stone
Bauxite	0.7mn tons	Poonch, Udhampur	Manufacture of aluminium
Coal	9.5mn tons	Kalakot, Moghla, Rajouri, Udhampur	Fuel
Magnetite	4mn tons	Panthal, Reasi, Udhampur	Refractory bricks for furnaces
Slates	1.5mn m ³	Baramulla, Doda	Building material
Sapphire	N/A	Doda, Paddar	Precious stone
Quartzite	2mn tons	Anantnag, Kupwara	Glass and IT industries
Dolomite	4.37mn tons	Kupwara, Udhampur	Refractory material
Borex	0.742mn tons	Rajouri, Udhampur	Borosil glass, enamels, ceramics, silver
China clay	28mn tons	Leh, Pogo Valley	Ceramics, pottery, paper
Bentonite clay	0.122mn tons	Udhampur	Abrasive, glass, pottery, moulding
Quartz and silica sand	3.1mn tons	Jammu	Drilling mud, refining oils, fats
Graphite	62mn tons	Baramulla	Crucible foundry, refractory, paints

Agriculture and horticulture

Where agriculture is concerned, productivity in LoC-East hovers around the Indian national average, which is low to begin with⁷¹. The nature of legal restrictions on land, as well as the absence of laws that regulate/formalise institutions such as contract farming also makes private investment in agriculture difficult. Although there is a large local market for meat, dairy and poultry products (LoC-East being a net importer of these products), the need for real time information on local demand and supply conditions (due to the perishable nature of the food products), coupled with the local legal framework, make large-scale investment in these sectors unlikely.

With regards to forestry, state laws that govern this sector along with Supreme Court judgments make large investments from the corporate sector difficult.

Horticulture is arguably different. This sector by its very nature is commercially oriented. The area under horticulture in the state is 325,134 ha. The production of fresh and dried fruit in LoC-East during 2010-11 was 22.22 lakh metric tonnes.

Half a million families are directly or indirectly involved in horticulture and as many as 2.7 million people in all are involved in the trade. Being a labour-intensive business, each hectare of orchard generates 400 man-days of employment per year. The striking characteristic of the sector in LoC-East is that although raw fruit is produced in abundance, there is very little value added to it by way of processing. LoC-East exported Rs. 4200 crores (\$840 million) worth of raw fruit in the year 2012-13, of which 90 per cent was apples⁷². Other crops include cherries, pears, apricots, chilgoza (pine nuts) and walnuts.

This is a severe gap but one that indicates a great opportunity as well. Investment in the fruit-processing sector requires capital and technology, as well as access to shelf space. It is just not for apples that this opportunity exists, but also exists for fruits such as apricots and cherries.

Hydroelectric power

Hydroelectric power is potentially the most attractive destination for investment in LoC-East. Its hydroelectric potential is estimated at 20,000 MW, of which only about 3000 MW has been harnessed⁷³. The bulk of this hydroelectric potential is along the course of the Chenab River, though the Jhelum and the Sewa (a tributary of the Ravi) also have potential. Currently, projects that generate power in the state are by and large owned and operated by the Indian government-owned Public

Sector Undertaking National Hydroelectric Power Corporation (NHPC) and are located in Salal (Reasi), Dul, Hasti, Baglihar, Kishanganga, Chamera.

Table 4 details the existing projects in LoC-East⁷⁴.

The dominance of NHPC in hydroelectric power generation is not a complete surprise. It must be remembered that power projects in general, and hydroelectric power in particular, are capital-intensive projects and few state government or private parties prior to 1991 could command the resources to set one up.

The concept of mini and micro hydroelectric projects are comparatively recent and, certainly in the licence-permit regime that existed in India before 1991 and the pride of place that the public sector undertakings occupied in sectors deemed critical, private players played a small or non-existent role.

Change in the power sector in India has been gradual. For most part, the State Electricity Boards in India were in poor financial health, because of inefficiencies and populism (whereby power was sold at rates far below the cost of generation or even given away free).

The legal framework to reform the power sector in India is the Electricity Act of 2003. However, because of Article 370, the Act is not applicable to LoC-East where the regulatory framework is governed by the Jammu and Kashmir Electricity Act, 2010 under which the Jammu and Kashmir State Electricity Regulatory Commission (JKSERC) has been empowered to:

- Determine the tariffs for electricity.
- Determine the tariff payable for use of the transmission facilities.
- Regulate power purchase and the procurement process of the transmission and distribution utilities, including the price of procurement.

In keeping with the reforms in the rest of the country, the state government of LoC-East proposes to break up the Jammu and Kashmir Power Development Department (JKPDD) into the following companies:

1. Jammu and Kashmir State Power Transmission Company Limited
2. Jammu and Kashmir State Power Trading Company Limited
3. Jammu Power Distribution Company Limited
4. Kashmir Power Distribution Company Limited

The process of unbundling is still to be done. But as of now the state government of LoC-East reserves

the right to procure all power generated in the state at a price of its choosing. Given the financial state of the JKPD, even if the price is remunerative, investors will be wary of investing in hydroelectric power because the return on investment is deemed to be unsafe⁷⁵.

In any case, there has been some movement in this sector, which the NHPC again dominates, with independent power producers coming in where micro and mini power projects are concerned.

Table 5 gives the details of planned projects.

A lot of potential that remains to be tapped. But for this the JKSERC will have to come into its own and give rise to a regime that makes investment in hydroelectric power a profitable business. Then, large as well as small investors will have the confidence to invest in power.

Value-added investment

As was stated in Chapter III, LoC-East possesses some industrial hubs largely because of the generous subsidies that the state and central governments were offering. Excise duty concessions have ensured that local and non-local entrepreneurs have set up shop in the state. Thus, industrial estates in Samba, Kathua, Bari Brahmana (in Jammu Division) and Khanmoh, Shalteng, Rangreth and Lathipora in Kashmir Division host factories that manufacture items including cement, construction steel, paints, pharmaceuticals and plastics. Registered data in the Annual Survey of Industry reveals that 649 factories in the state added a net value of more than Rs. 3200 crores and employed 45,000 workers⁷⁶.

The numbers with regard to micro, small and medium enterprises (MSMEs) are more impressive. The number of registered small-scale industries (SSIs) in 2010 was 53,157 employing more than 247,000 people⁷⁷. These units include handicrafts, such as shawl-making, papier-mâché and so forth, the demand for which in the national and international market is immense and can survive without any government largesse.

Investors wishing to invest must therefore weigh the premium that customers are willing to pay for their product against the high running costs of business in LoC-East. Their choice of product must be such that the premium price neutralises the high costs of power and transport.

Entrepreneurial class and potential

In LoC-East, business in 1947 centred on the fruit trade. The onset of industrialisation saw the emergence of a small industrial class, but the

Table 4. Hydroelectric projects in LoC-East

Name of power house	Installed capacity (MW)
Owned and operated by the LoC-East state government	
Jhelum River Basin	
Lower Jhelum	105
Upper Sindh-I	22.6
Ganderbal	15
Upper Sindh-II	105
Pahalgam	3
Karnah	2
Chenab Basin	
Chenani-I	23.30
Chenani-II	2
Chenani-III	7.50
Bhaderwah	1
Baglihar	450
Ravi Basin	
Sewa-III	9
Indus Basin	
Iqbal	3.75
Hunder	0.40
Sumoor	0.10
Igo-Mercellong	3
Haftal	1
Marpachoo	0.75
Bazgo	0.30
Stakna	4
Total	758.70
Central Sector (NHPC)	
Salal HEP	690
Uri-I	480
Dul-Hasti	390
Total	1560

Table 5. Planned hydroelectric power projects

⁷² S.No.	Project name	Basin name	Estimated capacity (MW)
1	Sawalkote I&II	Chenab	1200
2	Baglihar-II	Chenab	450
3	Parnai	Jhelum	37.5
4	New Ganderbal	Jhelum	93
5	Lower Kalnai	Chenab	50
6	Kirthai-I	Chenab	240
7	Kiru	Chenab	600
8	Rattle	Chenab	690
9	Kawar	Chenab	520
10	Ujh Multipurpose Project	Ravi	280
11	Pakul Dul (Central Sector)	Chenab	1000
12	Bursar (Central Sector)	Chenab	1020
13	Kishenganga (Central Sector)	Jhelum	330

Table 6. Independent power producer projects

S.No.	Project name	District	Capacity (MW)
1	Rattle	Kishtwar	850
2	Athwathoo	Bandipura	10
3	Tangmarg	Baramulla	10
4	Hirapora	Pulwama	12
5	Brenwar	Budgam	7.5
6	Kahmil	Kupwara	4
7	Boniyar	Baramulla	12
8	Mandi	Poonch	12.5
9	Ranjala Dunadi	Doda	15
10	Drung	Kathua	5
11	Hanswar Paddar	Kishtwar	6
12	Shukhnag	Budgam	9
13	Nihama	Kulgam	6
14	Shaliganga	Budgam	4.5
15	Bringi	Anantnag	4
16	Gulabgarh	Reasi	6.5
17	Boniyar	Baramulla	6
18	Mawar	Kupwara	10
19	Erin	Bandipura	10
20	Chenani IV	Udhampur	7
21	Shranz	Baramulla	10
22	Kutmarg	Kulgam	7.5
23	Achura Gurez	Bandipora	7
24	Pomai Aridajan	Kulgam	4
25	Kutbal	Kulgam	3.5
26	Sultanpathri	Poonch	3
27	Upper Ans	Rajouri	3
28	Chingus-I	Rajouri	3
29	Chingus-II	Rajouri	3
30	Rongdo	Leh	9
31	Bairaas	Kargil	9
32	Tamasha	Kargil	9
33	Girjan Ki Gali	Poonch	12

dominant industrial presence was and remains to this day of national and international conglomerates like the Birlas, Cadilla, Berger, Godrej, Coca Cola and so forth. Local entrepreneurs dominate the hospitality and tourism industry, though national and international franchises are making their presence felt through the franchise route.

The state still dominates the power sector, though small players like Magpie are entering the mini and micro hydroelectric sector. The potential of this class is yet untested. Years of uncertainty brought about by internal turmoil coupled with maladministration hindered the development of this class. The dirigiste regime that governed India prior to 1991 did nothing to help this class grow.

The problems faced by this class today are inadequate infrastructure, especially road communication, and expensive power. The problem in Jammu and Kashmir compared with Indian states is particularly acute. In an era of liberalisation, when all state governments are vying for private investment, the earlier arbitrary checks on the private sector have now lessened considerably, but infrastructural constraints remain.

The various chambers of industry, including local chambers as well as local chapters of national

chambers, are active and articulate industrial opinion effectively, and are keen on cross-LoC trade as well as investment.

Appraisal

LoC-East is a land of massive opportunity that needs infrastructure, regulatory reform and entrepreneurship. In the case of regulatory reform, India and LoC-East have come a long way. Local and non-local businesses (including foreign investors) can set up shop freely. Yet there are vast, profitable areas that remain unexploited. The tourism industry is an under-exploited area that could radiate out from Katra to encompass large parts of Jammu District. In Kashmir, tourism is concentrated around Srinagar, Gulmarg, Sonmarg and Pahalgam. Clearly, entrepreneurship is called for in these sectors to spread tourism. In power, regulatory reform is key. In industry, too, choosing the right product to make, coupled with innovative marketing, is the way forward.

The cost disadvantages of a hill economy cannot be wished away. Thus, choice of product and marketing strategies assume importance. It is here that entrepreneurship comes into its own. This has not yet been displayed and herein lies the opportunity for others to invest in LoC-East.

Chapter VI: The Kashmiri diaspora: Potential and role

Introduction

Economically, the rejuvenation of the private sector is seen as a primary component of peacebuilding in countries making the transition from war to peace. Failed growth is regarded as having dire consequences, and the investment of capital and know-how seen as essential to serving as a bulwark against a return to violence. Employment, trade, direct investment, and flourishing local enterprise are seen as pillars of stability for post-conflict societies such as Kashmir⁷⁸.

The role of diasporas in private sector rejuvenation in conflict and post-conflict societies is a bridge between understanding how diaspora communities can facilitate cross-border trade, investment, access to technology and skills, and how this can be used to build peace and develop post-conflict regions to prevent the re-occurrence of conflict.

The ability of diasporas to secure material and intangible resources to fuel armed conflicts through murky financial networks that enable the transfer of arms and money to combatants has been a subject of much conjecture⁷⁹. On the other hand, diasporas provide a vital source of humanitarian

assistance for civilian victims and support for post-conflict socio-economic recovery through remittances, helping to build institutions in terms of security, governance and instilling human rights, raising levels of employment and promoting growth and prosperity⁸⁰.

This chapter looks to assess the transformative potential of the UK Kashmiri diaspora community as a private sector investor in the erstwhile Princely State to build a stable and lasting peace. Although the potential for diaspora investment is strong in terms of capital and expertise ripe for transfer to Kashmir, perceptions exist among the diaspora that have been challenged by the work in this publication.

Further work is required, then, in matching the diaspora potential for investment with the opportunities available in Kashmir. The potential for economic engagement derives from access to capital and expertise, but must be matched by an inclination and awareness of the business opportunities still present in Kashmir – one of the central aims of this publication.

Context

The inherent economic motives of Kashmiri migration to the UK can be traced back to the 1880s when Kashmiris worked as stokers on ships, with additional waves of immigration linked to the construction of ships thereafter. The most intense period of migration began with the 1962 Migration Act and construction of the Mangla Dam in Kashmir, which displaced the inhabitants of many villages close to its site. It peaked in the late 1970s but continued at a significant level throughout the early years of the 21st century⁸¹.

Migrants were generally males of a middle socio-economic rank in their homeland, who went on to find work in the textile and steel industries in northern England. They sent remittances back to their rural origins, and encouraged and helped others to migrate from within their families and rural networks.

There are around 800,000-960,000 people of Kashmiri origin living in the UK today, generally deriving from LoC-West⁸². The proportion of the Kashmiri diaspora that comes from LoC-East is considerably smaller; it is difficult to find an exact number, because of the lack of categorisation in census data, but it is thought to number a few hundred families⁸³. They are far more likely to be engaged in professions such as law, medicine and academia than business and entrepreneurship.

British Kashmiris hold a unique economic trajectory, with business and entrepreneurship replacing their dependence on industry when the UK switched to a service-based economy⁸⁴. Subsequently, around 20 per cent-25 per cent of British South Asians (of which Kashmiris form a sizeable part) are categorised as entrepreneurs, compared with around 11 per cent of the British population as a whole⁸⁵.

British South Asian-owned businesses are productive, with a population measuring 4 per cent accounting for 6 per cent-10 per cent of British GDP⁸⁶. Determining how much of this is attributable to Kashmiris is, however, beyond the scope of the present report.

Sectors, capital and expertise

The Kashmiri diaspora has made inroads into several business sectors in the UK since the decline of industry. Their newly established businesses include car dealerships and garages, property letting (specifically buy to let), insurance, travel and tourism (from taxi ranks to cargo/freight) and running restaurants, as well as different aspects of the industrial sector (food processing and textile production). Similar to both sides of the LoC, Kashmiri entrepreneurs in the UK hold a

combination of capital, labour and knowledge that is biased towards the service sector, leaving interest in heavy industry underdeveloped.

The Kashmiri population has contributed significantly to the £3.5-billion British curry industry, with the British Curry Award often shared between Birmingham and Bradford, two large concentrations of the British Kashmiri community⁸⁷. Major examples of Kashmiri enterprises engaged in this aspect of the hospitality sector include the Aagrah and Mumtaz chain of restaurants, with the latter also dabbling in processed ready meals that have gained space in giant supermarket chains such as Tesco.

Kashmiris are present in wholesale and manufacture of finished food products; for example, Kashmir Crown Bakery (KCB), known as the 'largest Asian Food Manufacturer in Europe', and Regal Bakeries. KCB and Mumtaz represent microcosms of the skills and expertise employed in becoming flag-ship enterprises within the hospitality and food manufacturing industries.

The resilience of these businesses, even in times of economic recession and in highly regulated industries, is based on the ability of Kashmiri entrepreneurs to see gaps in the market for their products, acquire capital from alternative sources (often family and close friends) and to reduce fixed costs such as staffing (again through family) and finance on start-up^{88, 89}. The Mumtaz Group is known to have a turnover of around £25 million and KCB operates with a workforce of up to 150. Furthermore, their growth in times of economic recession is a testament to both organisations' skills in managing capital and labour⁹⁰.

The Kashmiri contribution to the travel and tourism industries, as well as the transport market through taxi ranks, for example, has also been impressive, with up to 100,000⁹¹ male taxi drivers of Kashmiri descent resident in the UK and major taxi ranks owned by Kashmiris. All in all, diaspora capital capacity remains significant, with UK-based Kashmiris annually contributing £500 million-£1 billion in remittances⁹².

Further analysing the potential for diaspora investment cross-LoC, Memsaab Boutique of Luton, a fashion retail and wholesale company run by a couple from the Kashmiri diaspora, has successfully formed a bridge between home and host country. After borrowing collateral and labour power from family to set up their first shop in Luton, the Memsaab Boutique founders have three retail outlets in LoC-West and one business partnership (manufacturing) in Delhi for export. The staff in Kashmiri outlets of Memsaab often employ UK experience and skills in their dealings

with customers, a prime example of how customer-service skills and non-capital resources can be transferred to the country of origin⁹³.

Likewise, the Nafees Group (a subsidiary of KCB) is backed by British-based capital, UK-developed production technologies and market knowledge to engage with the training of Kashmiri workers and production strategies in their portfolio of successful investments (in hospitality, event management and retail) in LoC-West. The introduction of photo cakes and the use of organic wheat in baking by the Nafees Group are two examples of the transfer of technological expertise and market knowledge imported by diaspora communities.

Research contends those South Asian British businesses that have maintained or strengthened their links with their country of origin have performed better than others, with traditional non-reliance on banks for start-up capital a facilitator of growth. Interestingly, the decision to invest in employee training has had a positive impact on growth for British South Asian businesses, an approach that has been engendered with Kashmiri diaspora investment in Kashmir⁹⁴.

Impediments, inclination and facilitation

A combination of existing literature on the topic of diaspora investment in conflict scenarios and community-based research work conducted under the remit of this study have looked at the scope for development and better understanding of the mot gal and market environment is rapidly developing and accurate information is scarce.

The multi-million pound Aziz Textiles Company of Birmingham has invested in infrastructure projects such as hospitals and roads in Kashmir⁹⁵, which has the potential to increase jobs and growth in LoC-West, and is also linked to the positive economic phenomenon of technology transfer.

In the same vein, and fundamentally relevant to this study, experts in the field of diaspora investment in conflict zones have signified the importance of altruism as a motivational dynamic in the decision of diaspora entrepreneurs to invest in their country of origin⁹⁷. This activity by the welfare wing of a significant diaspora-owned company is no doubt linked to positive psychological and social returns (linked to altruism, the 'feel-good factor' and also social status), rather than pure profit motivation.

Taking the perception of ethnic advantage and altruism as a given, using a model deriving from research on impediments to Palestinian diaspora investment in their homeland, research conducted within the scope of this study asked members of the

Kashmiri diaspora to rank perceived impediments to starting up business in their own country of origin (table 7).

The data collected from this exercise helped to establish a hierarchy of impediments that policymakers and practitioners can use to find solutions. Crucially, the results indicate that the main impediments perceived by the Kashmiri diaspora community are issues that would be associated with regional governments and government representatives at all levels, rather than wider geo-political conflict.

Diaspora engagement also showed that hesitancy was based on experiences related to perceived political risks (such as lack of sufficient guarantee for investment and the lack of logic in investing in a region prone to military crack-downs), structural obstacles (such as the idea that investment would have to be rubber-stamped in New Delhi and Islamabad) and logistical factors based on negative experiences (such as difficulty in obtaining visas to visit the region, with a legal marginalisation of the diaspora Kashmiris by Pakistani and Indian authorities often lamented by members of the diaspora)⁹⁸.

Perceptions of structural barriers such as corruption and nepotism, an inchoate tax system that unduly benefits Islamabad and two distinct government practices of the Pakistani and LoC-West governments, in which sales tax goes from Jammu and Kashmir-based businesses back to the Federal Board of Revenue (FBR) for redistribution to provinces of Pakistan other than LoC-West is considered a slight by the British Kashmiri diaspora⁹⁹.

Logistical and infrastructural issues – discussed elsewhere in this publication, as well as during engagement between authors of this study and members of the diaspora – are also mentioned as obstacles for investment, with diaspora communities wary of the lack of a dry port in Kashmir (increasing export costs), lack of constant energy and archaic communications mechanisms.

For example, diaspora interviews and research of the scarce literature regarding investment obstacles in Kashmir¹⁰⁰ have pointed to damaged and outdated Pakistan government-owned Special Communications Organisation telecommunications infrastructure in LoC-West as responsible for the inability of telecommunications companies to take off as they have done in India. Nonetheless, as the ranking shows, diasporas are willing to work around infrastructural issues, prioritising legal and governance-related fears as impediments to investment.

Table 7. British Kashmiri diaspora rank of investment impediments

Rank overall	Impediment	Mean score
1	Weak legal system	2.86
2	Too few incentives provided by Kashmiri/Indian/Pakistani governments	2.75
3	Cumbersome government bureaucracy	2.67
4	Government corruption	2.57
5	Absence of pro-business government	2.5
6	Unclear who in the government has the authority to approve or facilitate foreign investment	2.5
7	Lack of specific investment opportunities communicated to smaller overseas investors	2.25
8	Internal strife	2.25
9	Poor physical infrastructure	2.17
10	Weak financial system	2.08
11	Hostilities with neighbouring countries	2.06
12	Problems with labour/labour laws	1.83
13	Lack of UK government support for investment in Kashmir	1.83

1 = not an impediment, 2 = an impediment 3 = a major impediment

Appraisal

In summary, although diaspora communities should generally benefit from an ‘information advantage’ of shared cultural background and established social links to reduce transaction costs and establish partnerships in their country of origin, this is being undermined by perceptions that generally ward against any inclination to invest in the region.

If any inward investment incentives on both sides of the LoC exist (both fiscal and structural), this could prove to tip the balance in increasing meaningful investment from diaspora communities

on both sides of the LoC – yet knowledge of such investment incentives remains relatively low among the diaspora and lack of progress on some developments has dented confidence¹⁰¹.

In line with these preliminary findings with regards to the capital, expertise and inclination of the Kashmiri diaspora population, the next chapter will seek to summarise and posit some preliminary measures to maximise the potential for attracting diaspora investment across both sides of the LoC to further the links in a wider peacebuilding process.

Chapter VII: The path ahead

Why cross-LoC investment?

An analysis of the economic structures of LoC-East and -West, and indeed events on the ground, has revealed the limits of the potential of cross-LoC trade. The relatively small economies and absence of any significant complementarity in the production structures, as well as the poor state of communications, have contributed to this. This state of affairs is not likely to change any time soon.

Moreover, trade remains captive to artificially drawn short-lists and ‘proxy’ intakes in major parts. The situation may not alter drastically, even if irritants like the restrictions on items traded were to go and the trade-facilitation regime at the LoC crossing points to become frictionless. Cross-LoC trade even if boosted would not increase very significantly. Thus, economic integration or mutual interdependence through cross-LoC trade is unlikely to happen.

Under such circumstances a new structure would have to be thought of to increase economic integration across the various legal, political, economic and social divides in Jammu and Kashmir, and to promote rejuvenation of economies for a greater stability in the region. Arguably, investments on either side of the LoC and between the divides will eventually promote long-lasting trade that brings dividends to the region.

Greater investment in the erstwhile Princely State will generate wealth and enhance growth, thus lessening dependency on grants from the Pakistani and Indian governments. In any case, movement of production factors (in this case capital) logically follows movement of goods and services. This study has sought to see where investment opportunities lie on both sides of the LoC, as well as the type of entrepreneurs that exist on both sides. Additionally, it has attempted to introduce a new set of potential players: the expatriates from both sides of the LoC.

Where to invest?

In the industrial sector it is clear that on both sides of the LoC, extractive- and mineral-processing industries constitute a potential area of investment. Thus, cement and marble extraction are potential areas where investors may be attracted. Similarly, given the abundance of raw fruits, agro/fruit processing is also an area that could attract investment.

On a larger scale, the hydroelectric potential sector on both sides of the LoC could attract investment given the energy hunger that exists in India and Pakistan.

Tourism, which is already big in LoC-East and fast expanding in LoC-West, is still far from reaching its full potential and therefore is a prime candidate for investor attention.

Who are the investors?

The question that arises is who will be the investors? Is there any complementarity in the skill/core competencies of businesspeople of LoC-East and West?

This question at first seems to elicit a depressingly negative response. LoC-East has an industrial base and thus an industrial class with some experience of managing industry, a level of technological skill and access to capital. A matching class in LoC-West with similar or complementary skills is in its infancy.

However, the scene changes dramatically when the expatriate population from Jammu and Kashmir resident in the UK are brought in to the picture.

As Chapter VI reveals, this expatriate population is largely from LoC-West and has a large proportion of entrepreneurs (a characteristic of the South Asian diaspora). Fortuitously enough, the competencies of this entrepreneurial class include the services sector, particularly in the hospitality sector (ie hotels and restaurants). It also includes entrepreneurs in the area of processed foods.

Equally importantly, the remittances that are sent to LoC-West annually indicate the size of resources that these businesspeople can command.

Thus, introducing a new set of actors (the UK Kashmiri diaspora) brings, on behalf of LoC-West, a set of entrepreneurs who have matching resources and complementary skill sets compared with the entrepreneurs of LoC-East. A basis for promoting investments on either side of the divide and also some sort of cross-LoC investment now seems to exist.

However, given the narrowness of the local market, it is clear that these investments will be profitable only given the links that LoC-East and West have with the rest of the Indian and Pakistani economies.

Jammu and Kashmir will thrive only if it is poised to benefit from the broader economic integration process in South Asia. Cross-LoC investment will enable Jammu and Kashmir to exploit this market better, either through sales of goods or tourism as more people visit the state.

Will there actually be investment?

Private investment is primarily driven by the logic of profit and in a climate of uncertainty perceptions play a very important role.

Where profitability is concerned, this study has indicated that there are various sectors where potential profits are very high. However, a large number of factors can prevent potential returns from appearing.

The primary factor that could prevent economic activity from taking place would be the return of widespread violence in the region. Even with militancy declining, the air of uncertainty that remains long after militancy has declined has a tendency to deter investment. Even rare but 'spectacular' strikes can create investor pessimism.

Secondly, the regulatory regime under which the economies of LoC-West and -East operate could be far less intrusive and more transparent. Diaspora business people have flagged this up. Their primary concern appears to be the image of an uncertain legal and financial system.

However, greater access to the region would show that there is very little ambiguity on most issues that come in the way of investments and related resort to courts of law. When it comes to incentives, the state governments of LoC-East and LoC-West provide generous incentives in specified areas of investment. But even without such incentives and subsidies it has been argued that there are areas such as tourism that are so profitable that incentives are not required.

A cumbersome bureaucracy combined with government corruption and anti-business sentiment is certainly bad for business on either side of the LoC. However, the index of economic freedom for both regions has been steadily increasing, as shown by its recognition by the governments of India and Pakistan.

There is little ambiguity about who controls/ approves/regulates foreign investment in LoC-East and LoC-West: the governments in Delhi and Islamabad, with state governments having control of matters such as ownership of land and supply of power. The financial system is also adequate, with a vast array of financial products and services to choose from to help finance enterprise.

But there is no doubt that if the diaspora is to be involved in the process of Cross-LoC investment, then the visa regime for both sides must become far less stringent. Here the role of institutions such as the Jammu and Kashmir Joint Chambers of Commerce and Industry is vital.

Their credibility is key to facilitating not only interaction between businesspeople across the various parts of the erstwhile undivided Jammu and Kashmir to lobby the governments of India and Pakistan, but also the respective LoC-East and -West governments, as well as to facilitate visas for *bona fide* businesspeople. Quite possibly, clarifications from the UK government or the government of any country where expatriates can base themselves could go a long way to allay fears about the security of investment.

The respective governments could do more where infrastructure is concerned. As it is, even domestic investment is constrained by power cuts as well as poor communications. In LoC-East, existing industrial estates that were designed to be better connected with assured power supply are now full. Fresh investment is slow to arrive, though cement has seen it come in. Similarly, the recent upturn in hydroelectric power generation in LoC-West has yet to be put to the service of industrialisation in the region.

In the area of tourism, an opaque and slow regulatory regime ensures that the flow of

investment in this sector, especially hotels, is sluggish even though for long stretches no room can be had 'for love nor money.' Given such shortages, this lack of investment indicates the red tape that exists in the regulatory regime.

Diarchy has been a delaying factor in time-efficient decision-making. Concurrently, despite being announced with much fanfare, one-stop shops have never been successfully rolled out. However, over time business has managed to negotiate these obstacles in various ways. It is quite likely that these irritants at the local level will take some time to be tackled. But as of now business can and indeed does coexist with them.

What is more crucial is the security of investment. In this regard, the Indian government's decision to allow Pakistani nationals to invest in India or a possible matching Pakistani measure may not be sufficient for invigorating the special setting of Jammu and Kashmir. It is important that in a shared drive for stability in the region, the two governments unfold an agreement to possibly designate the state as a special investment zone, facilitate the flow of capital and guarantee investments there.

This instrument should also sanction investment promotion bureaus on either side and establish a mutual interface. This measure would inject confidence among the diaspora population from Jammu and Kashmir, who mostly hold British passports, and translate their positive inclinations into reality.

An additional ingredient (and possibly the most important one) is the role of investor perception about the region. A twist in this tale is that whereas perceptions about one's area of operations (or in the case of expatriates, one's area of origin) are well set, what need to change are perceptions about the region across the LoC.

It will be highly relevant to find an intra-Jammu and Kashmir institutional arrangement geared to enlarging awareness about the investment opportunities and its dividends. This will also require a coordinated set of programmes in the form of road-shows, and investment meetings by the governments of LoC-East and LoC-West where relevant information is disseminated.

A sequential list of things to do may be unrealistic at this time. States move slowly on laws, especially where security is concerned. Businesspeople are wary investors as prudence demands. Cross-LoC investment is a relatively new idea, but so was cross-LoC trade.

Clearly there is a need to disseminate information about the actual conditions in LoC-East and LoC-

West. This could be done through investment fairs and road shows, or given the focus of this study, by narrowing the focus to the diaspora population and directly communicating with them.

However, given the relative importance of first-hand accounts, a delegation of businesspeople comprising expatriates could easily be invited to see what conditions actually obtain and how current perceptions match up to facts and what could be done by the respective governments, whether

incrementally or otherwise, to materially change things on the ground for cross-LoC investment to materialise.

Cross-LoC investment, as this study argues, is more promising and cements relations between LoC-East and -West. The complementarities of entrepreneurial talent that exist indicate that this may be a better experience than cross-LoC trade was.

Endnotes

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