

Balusa IV

INDIA AND PAKISTAN:

**OPPORTUNITIES IN ECONOMIC GROWTH,
TECHNOLOGY, AND SECURITY**

A Report of the Balusa/Muscat, Oman Group

by Shirin Tahir-Kheli

*Based on a conference of senior Indian, Pakistani, and U.S. participants,
held at the Al Bustan Palace Hotel, Muscat, Oman, March 20-23, 1998*



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Preface

The Foreign Policy Research Institute was pleased to arrange a meeting of senior leaders and officials from India, Pakistan, and the United States on March 20-24, 1998 in Muscat, Oman. This gathering, the fourth of its kind, was lead by Senior Fellow Ambassador Shirin Tahir-Kheli. A special feature was the participation of senior officials from the Sultanate of Oman.

All of the meetings have been conducted with a singular theme: that India and Pakistan must find a way to improve their relationship for the sake of their own, and regional, peace and prosperity. Since May of 1996, when Ambassador Tahir-Kheli launched this initiative, the official relations between New Delhi and Islamabad have been erratic. A high point was reached when the two prime ministers met in 1997 in the Maldives, but more recently, friction over Kashmir, violent incidents, and election campaigns in both countries have curtailed such contacts. In this context, the Oman meeting reminded the participants of two important facts: first, as this report notes, the peoples of both India and Pakistan have become less hostile while the governments have become more hostile; second, the engine that will drive relations is economics.

I am happy to add my view to that of the participants in affirming that practical projects beneficial to both countries, such as joint investment in a natural gas pipeline, will help to overcome both the lack of political will and the mistrust that still pervades the political establishments. For the sake of regional harmony and the long-suffering peoples of the Subcontinent, this cannot happen soon enough.



Harvey Sicherman, Ph.D.

President, FPRI

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A Report of the

Balusa\ Muscat, Oman Group

March 20-24, 1998

by

Shirin Tahir-Kheli, Chairman of the Project

A small group of senior leaders, officials, and former officials from India, Pakistan and the United States have been meeting since May 1996 to discuss ways to make the future of the subcontinent brighter. At the previous three meetings,¹ different aspects of future collaboration, to include economic, political, and security issues were explored with an emphasis on the benefits that flow from economic cooperation, like increased trade, and joint ventures such as the construction of a joint natural gas pipeline. The meetings were private but the outcome of the discussions has been publicized widely through an agreed report.

The Muscat meeting was different in that the group invited the Special Advisor to the Sultan for External Liaison and host of the meeting, H.E. Dr. Omar Bin Abdul Muneim Al Zawawi, to address the group and to lead a distinguished group of senior officials from the Sultanate of Oman to exchange views with the participants on issues relating to regional developments and cooperation in the energy sector, particularly the possibility of a joint natural gas pipeline between India and Pakistan. The list of participants from Oman follows:

¹ Reports of the Balusa\Bellagio; Balusa\Maldives; Balusa\Princeton groups, Foreign Policy Research Institute, 1996-97.

H.E. Dr. Omar Bin Abdul Muneim Al Zawawi, Special Advisor to His Majesty Sultan Qaboos bin Said for External Liason

H.E. Yousef bin Alawi bin Abdullah, Minister for Foreign Affairs

H.E. Abdul Aziz bin Mohammed Al Rowas, Minister of Information

H.E. Ahmed bin Suwaidan Al Baluchi, Minister of Posts, Telegraphs & Telephones

H.E. Mohammed Nasser Al Khussibi, Secretary of the Ministry of Economy

H.E. Salim bin Hassan Makki, Member of the Board of Oman Oil Company

The following from the India-Pakistan-U.S. group attended the Muscat meeting:

The Honorable Shahid Khakan Abbasi

Major General Mahmud Durrani

Air Chief Marshal S.K. Kaul

Ambassador Pratap K. Kaul

C. Raja Mohan

Makhdoom Shah Muhmood Qureshi

Hilal Raza

Governor Girish Chandra Saxena

Toufiq A. Siddiqi

Shirin Tahir-Kheli

Rangarasan Vasudevan

The fourth meeting of the group took place during March 20-24, 1998 within days of the formation of the new government in Delhi. Pakistani participants were interested in the hearing about the ways in which policies of the past government, particularly the relationships with India's neighbors, might be affected by the Bharatiya Janata Party (BJP government).

Oman offered a unique venue in that it has good relations with both countries of the subcontinent. As Dr. Zawawi said in his opening remarks (see appendix I): "The dividends to be derived from peace and prosperity will benefit India and Pakistan and all their neighbors. We in the Sultanate of Oman particularly feel that we stand to gain much in every aspect be it

economically or politically. We firmly believe that peace and amity between India and Pakistan will contribute in a very positive manner to the security and stability of the countries in the Persian Gulf and Indian Ocean region.”

With this opening sentiment, the meeting focused on an update of political events in both countries and the problems in the political/diplomatic dialogue that had brought progress to a halt. Discussions in Oman provided an important opportunity for discussion of cooperation in the energy sector. The group heard from Kent Biringer of the Cooperative Monitoring Center, Sandia National Laboratories, Albuquerque, New Mexico, a detailed briefing on the technology of verification for agreements and confidence building measures, with special reference to any agreement on Siachin

Political Update

Elections in India were discussed and participants felt that the results gave a fractured verdict with a hung parliament. A certain amount of uncertainty and flux was possible. The verdict at the polls was seen to demonstrate an urge for better governance and reflected anti-incumbency sentiments. Corruption was an issue in the Indian election, just as it had been in the last Pakistani election that resulted in the defeat of Benazir Bhutto. State level political parties based on regional and caste lines were reaching into the national mainstream and testing powers and influence at the Center. BJP tried to moderate some of its toughest stands on controversial issues. A national agenda for governance has been developed. The north-south divide was sidelined as the BJP made gains across the country. Security issues and the role of Pakistani intelligence agencies figured in the election campaign because of bomb blasts in some parts of the country. In return, the Pakistani government laid the blame for explosions in Pakistani cities firmly at the door of Indian intelligence agencies.

Discussion focused on the meaning of a BJP win and the context within which Mr. Atal Bihari Vajpayee would reach out to neighbors, particularly Pakistan. Some of the Pakistani participants felt reassured by the sentiments for continuation of a secular rather than fundamentalist national policy in India.

BJP review of strategic issues and the emphasis on security and nuclear issues were said to be awaited. It was hoped that the India-Pakistan dialogue would be re-started quickly.

Indian participants felt that the climate had changed in Kashmir from what it had been at the time of the first meeting of this group in 1996. Recent

elections in the state restored the political process and there were perceptions of greater normalcy. Pakistani participants saw Kashmir remaining a flash point and emphasized the need for some 'just' process to determine the will of the people beyond the recent election held in the state. The Indian participants emphasized the need to try to achieve only what is achievable in the medium term. Because Kashmir remains central to Pakistani politics, no government was said by the Pakistani participants to be able to ignore the issue. While the issue need not be made central to relations between India and Pakistan, it was said that putting the issue in 'deep freeze' would also not work. One of the senior officials from Oman offered the view that the wishes of the Kashmiris themselves should be taken in to account, something that can only happen in an environment of peace and stability.

Both sides regretted that propaganda against each other had become more strident, particularly in the electronic media. They called for the resumption of the dialogue started by the two prime ministers as the key to changing the mindset of suspicion and mistrust. The climate could be appropriate with the Nawaz Sharif mandate and the ability of Prime Minister Vajpayee to carry through any agreement with Pakistan.

On the economic front, Indian policy was said to oppose "heartless globalization" but not oppose WTO issues in order to continue to attract foreign investors. Some selective protection of Indian industry in consumer areas is likely under the slogan "India to be built by Indians." However, on the whole, the BJP government may be nationalistic but it will not be projectionist. It will support a free trade area under SAARC and encourage trade with Pakistan. It will continue economic liberalization, adopt policies geared toward an increase in the growth rate and provide cheaper, better, and improved products to the consumer.

A review of the situation in Pakistan focused on constitutional changes and their impact on the political system. The mandate received by the Muslim League in last year's election was expected to lead to a more stable political system. Yet developments such as the clash with the Supreme Court demonstrated the fragility of the system. Political divisions remain in the relations between the government and other political parties with whom it formed governments in the provinces. The 2/3 majority that the Nawaz Sharif government enjoyed in upper house, the Senate, might not last.

Pakistani perceptions of the BJP government reflected a great deal of wariness resulting from a fear of the unknown and a strident rhetoric of the past. However, Prime Minister Nawaz Sharif had said openly that he would judge the new government in Delhi by its deeds, not rhetoric. That was a

good sign as both sides recognized the need for an improvement in relations and a diminution of mutual mistrust.

Pakistan's current economic woes were well known. Ongoing negotiations with IMF, the high rate of inflation, devaluation, and high unemployment rates all pointed to the fact that economic issues were likely to remain at the top of the agenda. The government's strength in the national assembly offers it an opportunity to provide relief but also subjects it to greater expectations of performance.

India - Pakistan Relations

All participants recognized that, despite positive interest at the highest levels, there is lack of effective effort to push for a positive relationship. **The second key problem in Indo-Pak relations deals with the existence of mutual mistrust.** Participants strongly urged that Indo-Pakistan normalization be urgently addressed. The main issue is the generation of sufficient political will to tackle the issues. The meetings of the prime ministers needed to be purposeful, as occurred in the Maldives in November 1997.

Discussion focused on what constituted forward movement. It was said that improved relations would be projected in two different ways. One, the negative side, would be charges of a 'sellout.' However, the positive side of the improvement would more than compensate as it offered an enormous economic dividend. **Participants agreed that the locomotive that will drive the India-Pakistan relationship is economic.** Construction of a joint natural gas pipeline, improved communications, sale of power, trade, etc. are a must if the future is to look different from the past. Political leaders are likely to find substantial public support for this.

Political leaders will have to take the lead and take overall charge of attempts to improve relations. Neither the bureaucrats nor the military will be in a position to offer leadership in this direction, and such an improvement will not occur unilaterally. Mistrust is fed from perceived actions of covert agencies, and these negative factors will need to be remedied if improvement is to occur and be sustained. **While people-to-people contacts are improving and are less hostile, the attitude of governments has, however, hardened.**

The last decade can be termed a 'lost' decade for the subcontinent due to continued strained relations between India and Pakistan.

Perceptions in Delhi are that India would like to get beyond the earlier predicament when Pakistan was the central issue for India. The “Gujral Doctrine” was an attempt to liberate India from its Pakistan focus on the regional front. India wanted improved relations with its neighbors, including Pakistan, if possible, but without Pakistan, if unavoidable.

Other states can help promote better Indo-Pakistan relations. **For example, Oman, with good relations with each of the above can act as a “catalyst” for improvement. Some ways that this can happen in practical terms include encouragement for a sustained dialogue, joint investment by all three countries, etc.**

Energy Cooperation

Participants discussed the role of energy and cooperation of Oman with regional countries. **Possibilities of the cooperation on energy issues and projects can go forward despite difficulties on other issues. The construction of a joint natural gas pipeline project and the sale of electric power would yield substantial benefits to both countries.** There was some sentiment that that the gas pipeline project should involve western companies as a confidence building measure.

JOINT NATURAL GAS PIPELINE (See Appendix II)

Participants recognized that the energy needs of India and Pakistan are expected to double every 10-15 years for the next fifty years. All participants expressed strong support for the project promoting a joint natural gas pipeline from the north or west through Pakistan to India. During the various briefings on energy, it was pointed out that there is a huge gap in the demand of natural gas in India. This demand will increase four-fold in India between 1995 and 2010 and will more than double in Pakistan within the same time frame. Such a project would help meet critical need, be environmentally sound, and help create confidence between the two countries. Indian concerns regarding the security of supply could be met through a number of means, such as: through the involvement of third parties; the offer of guarantees and the checks and balances that the supplier country would require; provision of penalty clauses under international law; a take-or-pay clause; etc.

SALE OF ELECTRIC POWER (See Appendix III)

The discussion of the potential sale by Pakistan of excess power capacity to India was an immediately available option. It was discussed in some detail and a number of steps were identified (which are listed in appendix III) in order to implement the sale of power at the earliest. The participants felt that the countries would both benefit from early implementation of an appropriate agreement.

The discussions concluded with the review of confidence building measures discussed in earlier reports and brought them up-to-date. These recommendations were made as a group and publicly. (Items recommended for early implementation are underlined).

ECONOMIC

- ◆ Early meeting of the Deputy Chairmen of the Planning Commissions of both countries.
- ◆ Recognize the importance of cooperation in trade and economic matters.
- ◆ An early joint meeting of Finance and Commerce ministers.
- ◆ Increase opportunities for trade through official channels.
- ◆ Utilize SAARC mechanisms for removing trade barriers and implement expeditiously SAPTA II making a serious effort to have it in place by 2000. At the same time, recognize that the bilateral India-Pakistan agenda must go forward.
- ◆ Remove obstacles for private sector activity, set up a joint mechanism to encourage on a fast track approach, cooperation in the fields of agro-industry, tourism, telecommunications, infrastructure, etc.
- ◆ Exploit potential for cooperation in petroleum and renewable energy areas.
- ◆ Pursue immediately the Joint Natural gas pipeline project as it is to the mutual benefit of both countries. Also pursue a meeting of the ministers for Petroleum and Natural Resources and Energy. An official Joint India-Pakistan Working Group may be formed to discuss various aspects of the issue towards its implementation. The official working group may benefit from the work already done under UNDP aegis(including the participation from India and Pakistan at the technical and political levels).

- ◆ Urgent consultations on the possibility of purchasing and exchange of electrical power. A joint working group should be formed to discuss various aspects of the issue and its early implementation.
- ◆ Encourage private sector exchange visits including those between Chambers of Commerce to discuss joint projects, trade laws, policy implementation, etc.
- ◆ Further liberalize visas for business/commercial visits on the recommendation of the Chambers of Commerce.
- ◆ Encourage R & D collaboration, educational and student exchanges.
- ◆ Establish a working committee to promote cooperation in select areas of science and technology.
- ◆ Joint development of a SAARC communications satellite by the year 2002.
- ◆ Encourage tourism between India and Pakistan through the treatment of visitors from each country as visitors are from any other country.
- ◆ Increase the number of international sports events to include the national teams from each other's country.
- ◆ Recognize the importance of public education to correct wrong impressions on different issues, particularly the impact of increased trade and cooperation in industry and agriculture.

POLITICAL

- ◆ Reduce propaganda against each other, particularly in the electronic media.
- ◆ Accelerate the political dialogue at the highest level which must be sustained. More frequent and regular meetings of the prime ministers.
- ◆ To break the current stalemate at the official level, appoint a special emissary to elevate talks to the political level from the current bureaucratic level where it has mostly remained deadlocked.
- ◆ Encourage parliamentary exchanges.
- ◆ Revive the Indo-Pakistan Joint Commission.
- ◆ Greater access to each other's newspapers and exchange of print and electronic media individuals with enhanced access to political leaders.
- ◆ Cooperation in the elimination of Narcotics and Terrorism.
- ◆ Restrain subversive elements against each other.
- ◆ Periodic meetings at the appropriate level to consider measures to reduce border incidents and tensions and to review progress.

- ◆ Continued interaction between NGOs of both countries on matters of regional interest.

MILITARY / SECURITY

- ◆ Initiate military leadership interaction starting with the visits of National Defense College teams on study tours.
- ◆ Hot lines at the military level to work better, more regular and routine usage.
- ◆ Periodic review of existing agreements and public acknowledgment of the same.
- ◆ Continuation of pre-notification of large scale military exercises.
- ◆ Strike forces to be kept away at reasonable distances and timely notice of movement.
- ◆ Improve mechanisms for the settlement of border violations
- ◆ Improve mechanisms to reduce tensions along the LOC and the international border by de-centralizing contacts between the junior formation commander levels for flag meetings.
- ◆ Reach Agreement on Siachin and disengage military troops at the earliest.
- ◆ Renew discussions on a “no war pact”.
- ◆ Restraint in the deployment of missile delivery systems.
- ◆ Negotiations for an agreement for the non-use of weapons based on nuclear, chemical and biological technology.
- ◆ Initiate a formal dialogue on nuclear and missile issues to include doctrine and arms control.

In conclusion, participants pressed for the creation of political will for better relations and the lessening of mistrust. They pressed for early implementation of the joint natural gas pipeline project. Apart from offering clear economic advantages, such a project would highlight benefits and demonstrate visibly a changed posture between India and Pakistan.

APPENDIX I

TEXT OF WELCOME ADDRESS

GIVEN BY

H.E. DR OMAR BIN ABDUL MUNEIM AL ZAWAWI

Special Advisor to

His Majesty Sultan Qaboos bin Said

For External Liaison

BALUSA MEETING

Al Bustan Palace Hotel, Muscat

Saturday, 21st March 1998

Salutation

It gives me great pleasure to welcome you to the Sultanate of Oman and to convey to you His Majesty Sultan Qaboos bin Said's cordial greetings and earnest desire that your attempts and those of all people of peace and wisdom are crowned with success. We are confident in Oman that some day the brotherly relations between India and Pakistan shall overcome the feelings of mistrust that still exist among some of the citizens in both countries.

There will always be individuals or groups who will have extremist leanings and in their misguided ways cause grievous harm to their country. We welcome your presence here in the Sultanate of Oman in a spirit of friendliness and brotherhood, coupled with a willingness to work towards laying a sound foundation for the friendship and peace that must exist so as to contribute to the well being of all Indians and Pakistanis alike.

Your presence here and your attempts to work towards a closer relationship conveys to us a message which we wholeheartedly welcome and endorse. I have no doubt that with the dedication and efforts of committed individuals like yourselves, we will see an enhancement of the prospects for peace.

We are confident that by building an environment of peaceful and friendly relations a synergy can be created to improve the standard and quality of life for the peoples of India and Pakistan. The commonality of interests and the reaping of economic fruits from projects using each other's resources, would lead towards the creation of ventures whose economic benefits can be seen by job creation and other forms of investment returns. These ventures could be some of the more important results of your efforts and shall form the vital ingredients needed for the creation of a cycle of success.

We sincerely hope that further avenues can be explored leading to the promotion of economic, cultural, social and sports ties. These endeavours would help lay the foundations for dialogue at various levels and promote a form of healing which is much needed at all levels.

It is by the cumulative work of groups like yours that such a commitment to brotherly relations can be created. The dividends to be derived from peace and prosperity will benefit India and Pakistan and all their neighbours. We in the Sultanate of Oman particularly feel that we stand to gain much in every aspect be it economically, or politically. We firmly believe that peace and amity between India and Pakistan will contribute in a very positive manner to the security and stability of the countries in the Persian Gulf and Indian Ocean region.

We therefore express to you our desire to assist you towards achieving your aims.

I pray that this meeting in the Sultanate of Oman will help take you further towards your noble goals.

Close

*** **

APPENDIX II

**INDIA AND PAKISTAN OPPORTUNITIES IN
ECONOMIC GROWTH, TECHNOLOGY AND SECURITY**

IV MEETING, MUSCAT, OMAN

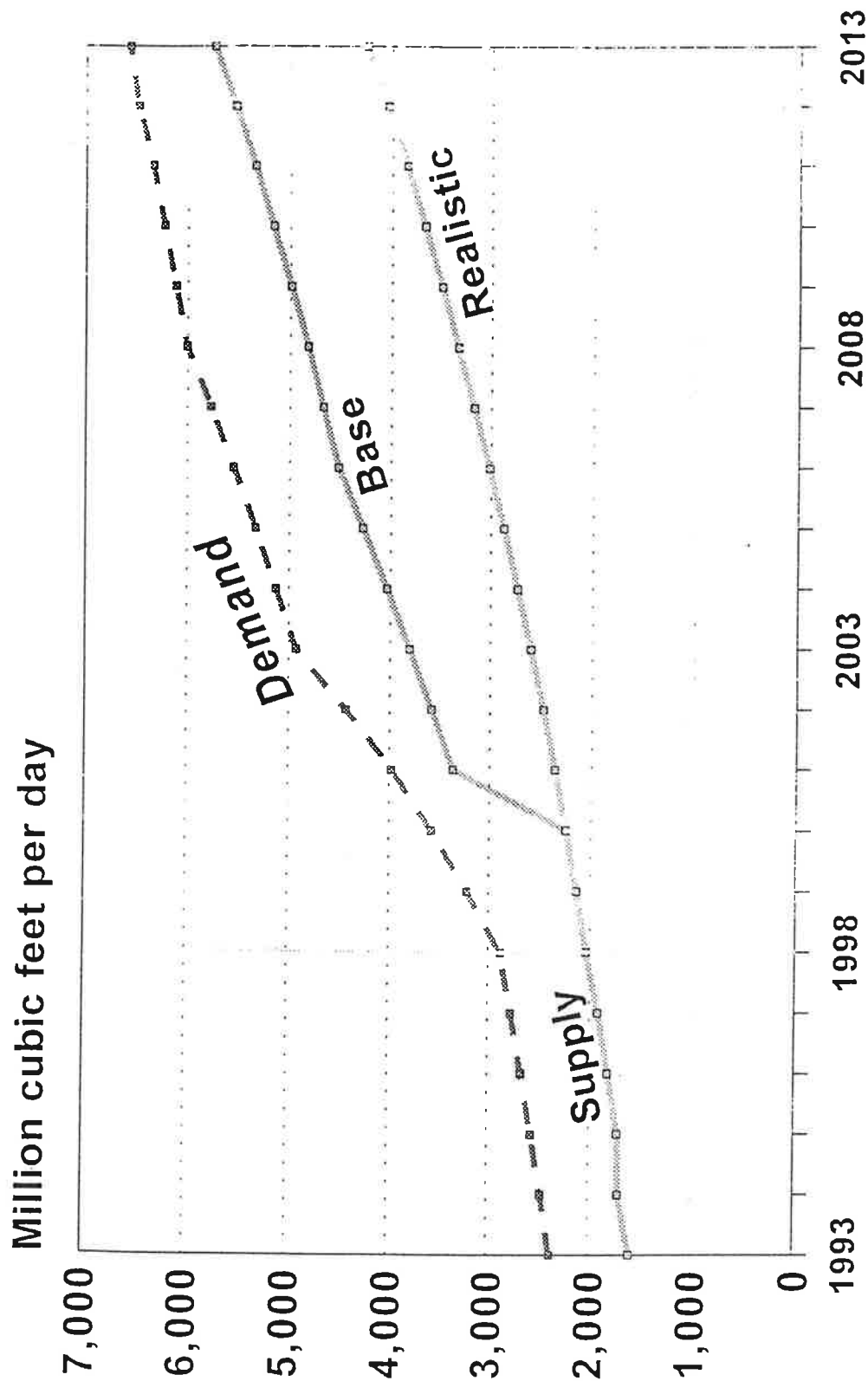
21-23 MARCH 1998.

NATURAL GAS IMPORT OPTIONS FOR SOUTH ASIA

BY

**HILAL A. RAZA
DIRECTOR GENERAL
HYDROCARBON DEVELOPMENT INSTITUTE OF PAKISTAN**

PEAK NATURAL GAS DEMAND-SUPPLY PROJECTIONS



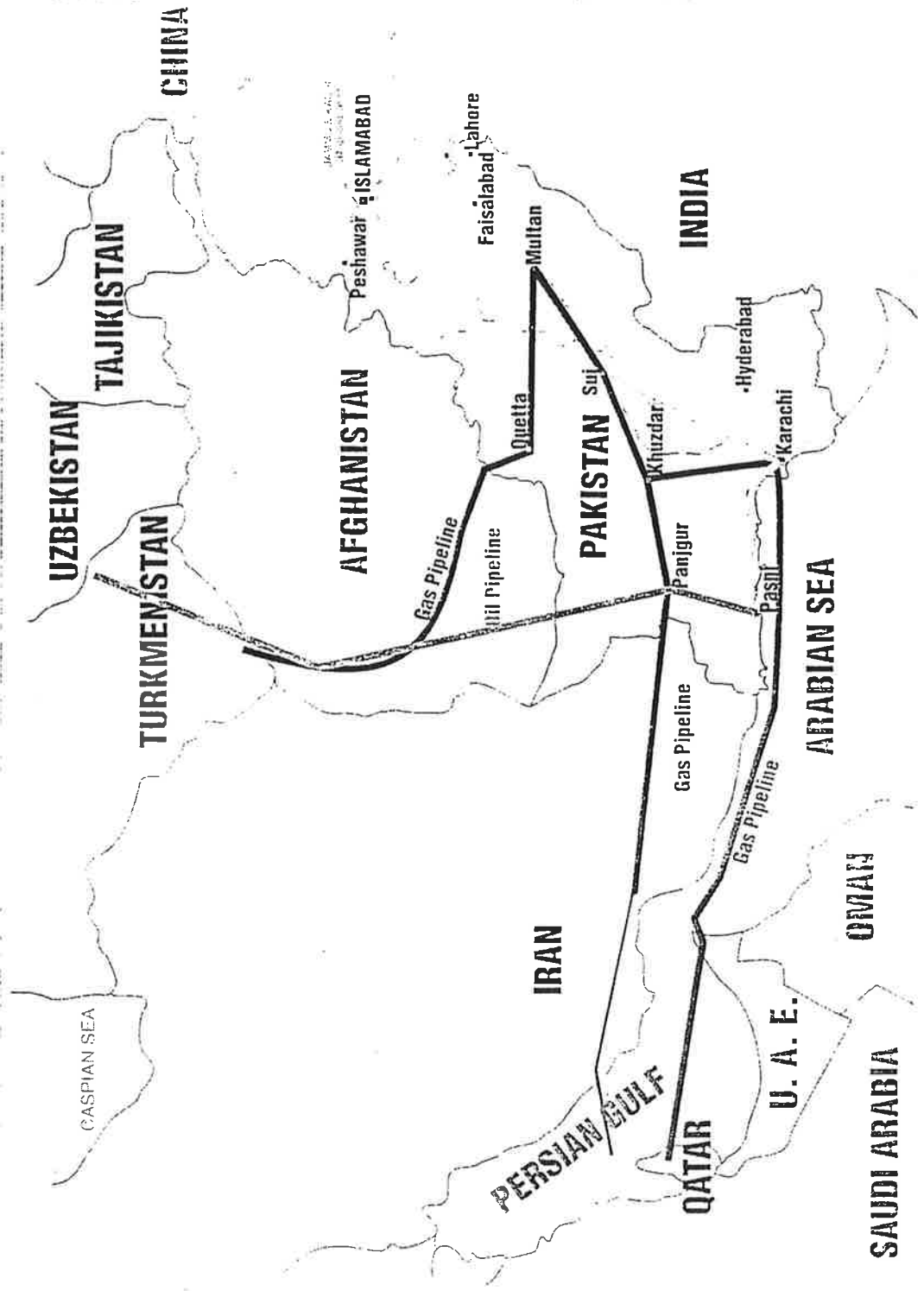
Scenario-I/Realistic:

Historic growth @ 5% p.a.

Scenario-II/Base:

Scenario-I + gas imports @ 1.0 BCFD from 2001 to 1.5 BCFD in 2006.

PROPOSED OIL & GAS IMPORT ROUTES



UNDP PROJECT CONCLUSIONS

- i. Optimal techno-economic solution is for India and Pakistan to jointly pose their demands to potential suppliers in the north and the west so that economies of scale result in a substantial reduction in the unit cost of supply to both countries.**
- ii. Inter-governmental arrangements between Pakistan and India need to be made to signify a joint and mutual declaration of intent and inuring the project from perceived non-commercial risks, especially those of political and security nature.**

UNDP PROJECT CONCLUSIONS (Cont'd)

- iii. Four major directions through which an appropriate climate of opinion can progressively be created are:
- Full fledged preparatory techno-economic work
 - Intergovernmental agreement
 - Informed public opinion
 - Promotion of international commercial and financial interest in the proposed projects.

Cont'd/...

UNDP PROJECT CONCLUSIONS (Contd.)

- iv. The governments of Pakistan and India are urged to positively pursue these proposals and address themselves to a number of issues including commercial terms, identification of routes, security of supplies, non-commercial risks such as natural disasters, political tensions, internal disturbances, terrorism, armed hostilities and international sanctions, joint supervision mechanism, modalities for settlement of disputes, and a time-frame.

OPTIONS EVALUATED

- **Pakistan Only (1.5 BCF/D).**
- **Pakistan-India (1.5+2.0 BCF/D).**

ASSUMPTIONS

- **Pakistan annual average 1.5 BCF/D.**
- **India annual average 2.0 BCF/D.**
- **Load factor $\geq 80\%$.**
- **Project Rate of Return 13%, 15%, 18%.**
- **Tax per annum: @ 49%, 30%.**
- **5-Year build-up from 67% to 100% of fully compressed capacity.**

Cont'd/...

ASSUMPTIONS (Cont'd)

- High pressure technology ANSI 900.
- Pakistan delivery to Multan and Karachi.
- India delivery from near Sui to Jodhpur (400 km).
- Postage stamp tariff for the whole system.
- 20 years economics calculated with residual project value.

NOTES

- The Sui-Multan and Sui-Jodhpur distances are similar, so a postage stamp tariff is reasonable for comparison.
- No transit fee is included. At international rates, a transit fee of \$0.40 would be typical.
- Project economics sensitive to Debt/Equity Ratio and Tax Rates.

CAPITAL AND OPERATING COSTS AND TARIFF OF FULLY OPTIMIZED PIPELINE WITH COMPRESSION

	Specs	Capital Cost (Billion US\$)	Annual Operating Cost (Million US\$)	Tariff @15% RoR & 49% Tax (US\$/Million BTU)
Pakistan Only	1.5 bcf/d 36" 2,800 km	2.54	35 - 55	1.03
Pakistan+India	3.5 bcf/d 48" 3,200 km	4.10	50 - 120	0.76

EFFECT OF DEBT OPTIMIZATION ON PROJECT RATE OF RETURN

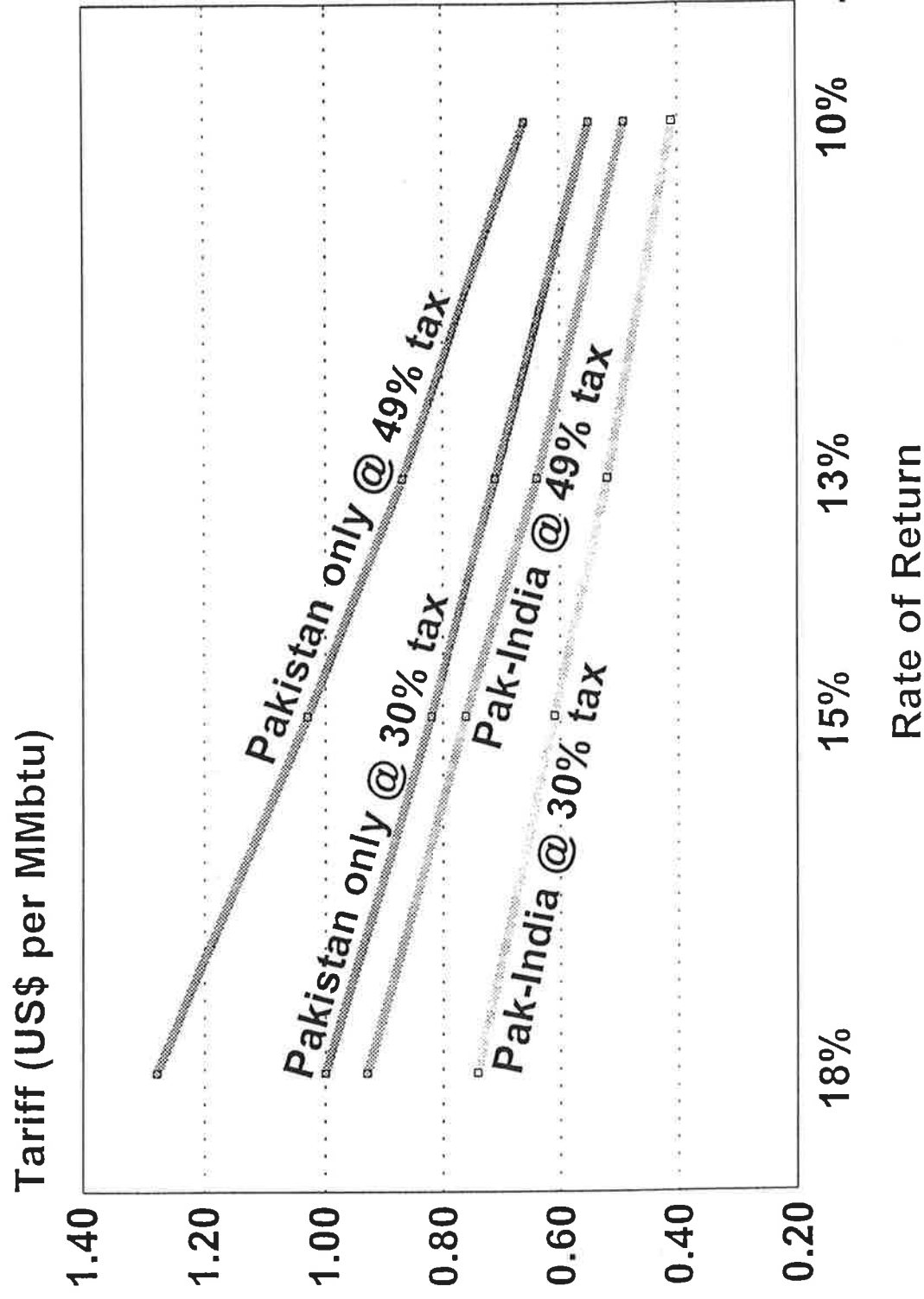
					Project RnR
Case I	Debt	50%	@	16%	8 } 18%
	Equity	50%	@	20%	
Case II	Debt	50%	@	10%	5 } 15%
	Equity	50%	@	20%	
Case III	Debt	50%	@	6%	3 } 13%
	Equity	50%	@	20%	
Case IV	Debt	70%	@	6%	4.2 } 10.2%
	Equity	30%	@	20%	

CALCULATED PIPELINE TARIFF

(US\$ per Million BTU)

Project RoR	Pakistan Only		India-Pakistan	
	<u>Tax-49%</u>	<u>Tax-30%</u>	<u>Tax-49%</u>	<u>Tax-30%</u>
18%	1.28	1.00	0.93	0.74
15%	1.03	0.82	0.76	0.61
13%	0.87	0.71	0.64	0.52
10%	0.66	0.55	0.49	0.41

Effect of RoR and Tax on Tariff



CONCLUSIONS

- **Economic analysis confirms that it is a win-win situation to have a joint gas import pipeline both for India and Pakistan, rather than separate pipelines.**
- **All issues between India and Pakistan need to be addressed in an integrated manner so as to obtain benefit of the vast economic potential available through a joint natural gas import pipeline.**

APPENDIX III

Political Sale of Electrical Power by Pakistan to India

Proposed Terms of Reference:

A. Technical Issues:

1. Review the capability of existing power systems in India and Pakistan to import and export power, and consider their technical characteristics and standards.
2. Determine the technical options and locations for interconnection between India and Pakistan, taking account of environmental issues.
3. Determine the project costs of each interconnection option addressed in A.2 above.

B. Commercial Issues:

1. Review the existing and proposed future prices and demands for electricity in India and Pakistan, including the identification of potential shortfalls or surpluses of power that may be served by an interconnector.
2. Consider the options for deriving revenues for the interconnector, including energy trading or a regulated return based on asset usage.
3. Consider the options for a contractual structure for the interconnector, identifying alternatives which would allow development by the public or private sector.

C. Financial Issues:

1. Review the project economics, including consideration of the alternative project costs, revenues, funding sources, electricity prices, and the potential economic benefits to each Government resulting from this development.

D. Recommendations:

1. Produce recommendations concerning the development of a potential interconnector between Pakistan and India, including plans for its implementation.