

CENTRO STUDI PER I POPOLI EXTRA-EUROPEI "CESARE BONACOSSA" - UNIVERSITÀ DI PAVIA

# ASIA MAIOR

THE JOURNAL OF THE ITALIAN THINK TANK ON ASIA  
FOUNDED BY GIORGIO BORSA IN 1989

Vol. XXVII / 2016

---

## The End of the Obama Era in Asia

Edited by  
Michelguglielmo Torri  
and Nicola Mocci

---

viella





Asia Maior. The Journal of the Italian Think Tank on Asia founded by Giorgio Borsa in 1989.

Copyright © 2017 - Viella s.r.l. & Associazione Asia Maior

ISSN 2385-2526

ISBN 978-88-6728-885-4 (paper) ISBN 978-88-6728-886-1 (e-book pdf)

Annual journal - Vol. XXVII, 2016

This journal of the Associazione Asia Maior is published jointly by Associazione Asia Maior & CSPE - Centro Studi per i Popoli extra-europei "Cesare Bonacossa" - Università di Pavia

The publication of this issue of the journal Asia Maior has been co-funded by a grant from the Italian Ministry of Foreign Affairs (MAE), whose help is here gratefully acknowledged. However, the opinions expressed in any given article in this issue are those of its author/s and do not in any way reflect the official position of the MAE

Editor (direttore responsabile): Michelguglielmo Torri, [mg.torri@gmail.com](mailto:mg.torri@gmail.com)

Junior editor: Nicola Mocci, [nicolamocci@yahoo.it](mailto:nicolamocci@yahoo.it)

Editorial Board: Axel Berkofsky, Simonetta Casci, Marzia Casolari, Nicola Mocci, Giulio Pugliese, Michelguglielmo Torri, Pierluigi Valsecchi

Book review editors: Oliviero Frattolillo, [oliviero.frattolillo@uniroma3.it](mailto:oliviero.frattolillo@uniroma3.it);

Francesca Congiu, [francesca\\_congiu@hotmail.com](mailto:francesca_congiu@hotmail.com)

Segreteria di redazione: [asiamaior@gmail.com](mailto:asiamaior@gmail.com)

Progetto grafico di Nicola Mocci

*Asia Maior. The Journal* is an open-access journal, whose issues and single articles can be freely downloaded from the think tank webpage:

[www.asiamaior.org](http://www.asiamaior.org)

|               |       |         |        |         |
|---------------|-------|---------|--------|---------|
| Paper version | Italy | € 50.00 | Abroad | € 65.00 |
|---------------|-------|---------|--------|---------|

|              |  |  |
|--------------|--|--|
| Subscription | <a href="mailto:abbonamenti@viella.it">abbonamenti@viella.it</a> | <a href="http://www.viella.it">www.viella.it</a> |
|--------------|--|--|



**viella**

libreria editrice

via delle Alpi, 32

I-00198 ROMA

tel. 06 84 17 758

fax 06 85 35 39 60

[www.viella.it](http://www.viella.it)

CENTRO STUDI PER I POPOLI EXTRA-EUROPEI “CESARE BONACOSSA” - UNIVERSITÀ DI PAVIA

# ASIA MAIOR

The Journal of the Italian think tank on Asia founded by Giorgio Borsa in 1989

Vol. XXVII / 2016

## The End of the Obama Era in Asia

Edited by

Michelguglielmo Torri and Nicola Mocci

viella



## ASSOCIAZIONE ASIA MAIOR

Steering Committee: Marzia Casolari (President), Francesca Congiu, Nicola Mocchi (Vice President), Riccardo Redaelli, Michelguglielmo Torri (Scientific Director)

Scientific Board: Guido Abbattista (Università di Trieste), Domenico Amirante (Università «Federico II», Napoli), Elisabetta Basile (Università «La Sapienza», Roma), Luigi Bonanate (Università di Torino), Claudio Cecchi (Università «La Sapienza», Roma), Alessandro Colombo (Università di Milano), Anton Giulio Maria de Robertis (Università di Bari), Thierry Di Costanzo (Université de Strasbourg), Max Guderzo (Università di Firenze), Franco Mazzei (Università «L'Orientale», Napoli), Giorgio Milanetti (Università «La Sapienza», Roma), Paolo Puddinu (Università di Sassari), Adriano Rossi (Università «L'Orientale», Napoli), Giuseppe Sacco (Università «Roma Tre», Roma), Guido Samarani (Università «Ca' Foscari», Venezia), Filippo Sabetti (McGill University, Montréal), Gianni Vaggi (Università di Pavia), Alberto Ventura (Università della Calabria)



## CSPE - Centro Studi per i Popoli extra-europei "Cesare Bonacossa" - Università di Pavia

Steering Committee: Axel Berkofsky, Arturo Colombo, Antonio Morone, Giulia Rossolillo, Gianni Vaggi, Pierluigi Valsecchi (President), Massimo Zaccaria

Authors publish in Asia Maior only on invitation. Invitations – which are made by the Director of the journal, after consulting the editorial board – are based on the invitee's curriculum vitae and his/her previous publications. Anybody willing to publish in Asia Maior is therefore invited to submit his/her curriculum vitae and list of previous publications, while indicating the Asian country which he/she would like to analyse, to the Director of the journal (writing to [mg.torri@gmail.com](mailto:mg.torri@gmail.com)).

Before being published in Asia Maior, any article is first evaluated by the Journal's editors, who have the power to decide either to refuse it or to further it to one or more referees. In the latter case, the editors decide the number of anonymous referees to which the submitted article must be sent for evaluation. This number varies between one and three.

Asia Maior is a double-blind peer-reviewed journal. Accordingly it is its policy not to make public the names of the reviewers. However, their names – and, if need be, the whole correspondence between the journal's editors and the reviewer/s– can be disclosed to interested institutions, upon a formal request made directly to the Director of the journal.

## CONTENTS

- 7 MICHELUGUGLIELMO TORRI & NICOLA MOCCI, *Foreword: Asia Maior in 2016*
- 17 FRANCESCA CONGIU & ALESSANDRO URAS, *China 2016: Defending the legitimacy of the party-state's authority*
- 53 AURELIO INSISA, *Taiwan 2012-2016: From consolidation to the collapse of cross-strait rapprochement*
- 89 MARCO MILANI, *Korean Peninsula 2016: The never-ending crisis*
- 121 GIULIO PUGLIESE, *Japan 2016: Political stability amidst maritime contestation and historical reconciliation*
- 143 CARMINA YU UNTALAN, *The Philippines 2016: Democracy in dispute?*
- 167 ELENA VALDAMERI, *Indonesia 2016: A difficult equilibrium amid global anxiety*
- 199 MICHELA CERIMELE, *Vietnam 2016: The aftermath of the 12<sup>th</sup> congress, between continuities and changes*
- 221 NICOLA MOCCI, *Laos 2016: The 10th congress of the Lao People's Revolutionary Party (Lprp) and its domestic and international aftermath*
- 243 PIETRO MASINA, *Thailand 2016: The death of King Bhumibol and the deepening of the political crisis*
- 261 MATTEO FUMAGALLI, *Myanmar 2016: From enthusiasm to disillusionment*
- 277 MARZIA CASOLARI, *Bangladesh 2016: A laboratory for Islamic radicalism*
- 297 FABIO LEONE, *Sri Lanka 2016: Does the new era continue?*
- 315 MICHELUGUGLIELMO TORRI & DIEGO MAIORANO, *India 2016: Reforming the economy and tightening the connection with the US (with an Appendix by MARCO VALERIO CORVINO, A brutal and violent year in the Kashmir Valley)*
- 385 MARCO CORSI, *Pakistan 2016: Economic features*
- 403 DIEGO ABENANTE, *Afghanistan 2016: Military crisis and contested reforms*
- 417 LUCIANO ZACCARA, *Iran 2016: From the Saudi embassy attack to the demise of Rafsanjani*
- 439 ADELE DEL SORDI, *Kazakhstan 2015-2016: Balancing regime stability amidst local and global challenges*
- 463 *Reviews*
- 483 *Appendix*

At the end of the day, however, the Congress' wobbling on the Kashmir question comes as no surprise and not so much because of a weakness by his leadership. Clearly, the unfeeling attitude of the BJP, the Congress, and the other main political parties to the repression unleashed in the Kashmir Valley was a reflection of the increasingly chauvinistic attitude of the articulated Indian public opinion. The Indian media – as had been the rule in the past – showed a complete closure to Kashmiri aspirations and, instead of being revolted by the sheer brutality of the repression in the valley, egged on the government for more repression and more violence, «celebrating the killing, maiming, and blinding of young Kashmiris». In particular: «Powerful TV studios urge[d] the state to be more aggressively macho, while actively suppressing or distorting news from Kashmir». <sup>60</sup> As noted by Yashwant Sinha: «Sections of the Indian media, specially some TV channels, are hated in the Valley with a passion which is unbelievable». And, as admitted by him: «They [the Indian media] have contributed in no small measure in creating the kind of misunderstanding which exists in the minds of the people there». <sup>61</sup>

Of course the prevailing aggressively chauvinistic attitude of the Indian public opinion as far as the Kashmir question is concerned does not mean that voices of sanity are completely absent. After all, the present analysis of the repression in Kashmir is largely based on articles authored by Indian journalists, intellectuals, and even politicians who represent these voices of sanity. However, this does not detract from the observation that the general closure of the Indian mind, so much in evidence since the BJP rise to power, is an undeniable and worrying phenomenon taking place under our very eyes. This being the situation, the attitude of the Indian public opinion towards the Kashmiri crisis is but one aspect, even if a particularly glaring and preoccupying one, of a more general and developing process.

60. Mirza Waheed, 'India's crackdown in Kashmir: is this the world's first mass blinding?'

61. Yashwant Sinha, 'Why Kashmir Is So Angry With Us'.

## PAKISTAN 2016: ECONOMIC FEATURES

*Marco Corsi*

Asia Maior – An Italian think tank on Asia  
macorsi@gmail.com

*This essay analyses the predominant domestic and foreign policy events that occurred in Pakistan in 2016 through the lens provided by the country's main economic developments.*

*With the aims of decreasing the fiscal deficit/GDP ratio and following the guidelines of the international financing institutions, Pakistan was implementing structural reforms aimed at increasing tax revenue, cutting public expenditures, easing the market interest rates through liberalisation measures, and improving the performance of the energy sector. Among these reforms, particularly the one related to the revenue system was highly needed. The description of Pakistan's overall taxation system and its features, given in this essay, provides also the background to contextualise the Panama Papers scandal that hit Pakistan and its Prime Minister in the year under review.*

*In 2016, concessional loans, while resulting in steady, but mild growth, did not ensure a long-term positive trend of sustained growth or of improvement of the economy of the country at large.*

*In the fiscal year 2016-2017, high budgetary allocations were confirmed for the defence sector, whose outlay was raised of about 18%. Over the years, costly military interventions launched to combat internal anti-government armed militancy have had a negative impact on Pakistan's economic growth in terms of resource reallocation, military expenditures, and the contraction of trade, business activities, and investments at large. Yet, military operations brought back under the control of the Security Forces areas which were the most volatile before the Army interventions. In 2016, fewer militants' attacks than in the previous year were recorded, mostly against soft targets like academic institutions.*

*Foreign relations were characterised by the deterioration of Islamabad's ties with Washington and New Delhi. At the same time, regional political realignments provided an unprecedented economic opportunity to Pakistan, with China becoming the leading economic partner of Islamabad. However, the relations with China were challenged by armed militancy and unrest, potentially capable to undermine the economic alliance of the two Asian countries.*

### *1. Introduction*

Pakistan's economy has alternated between low and high growth rates since 1947. Low rates marked the period immediately after independence, the 1970s, and the democratic governments of Benazir Bhutto and Nawaz



Sharif in the late 1980s and 1990s.<sup>1</sup> Higher growth rates were recorded during the military governments, particularly during the rule of General Zia-Ul-Haq (1979-1988) and of General Pervez Musharraf (1999-2008). More recently, the democratically elected government of Yousuf Raza Gilani (2008 - 2013) recorded a 3% growth in the GDP (Gross Domestic Product). Finally, during the current administration of Nawaz Sharif, national economic performance has mildly improved.<sup>2</sup>

The country has a long track record of dependence on ODA (Overseas Development Assistance).<sup>3</sup> Pakistan has been receiving support from international financing organisations since its birth, but in 1988, a Structural Adjustment Programme was launched under the aegis of the IMF (International Monetary Fund) and the WB (World Bank), entailing an initial package of neo-liberal policy reforms. Since then, the governments of Pakistan have been striving, with varying success, to implement the reforms needed to honour Pakistan's commitments to the international institutions.

The prominent role of Pakistan in the war in Afghanistan, particularly after 9/11, offered a game-changing opportunity for Islamabad in terms of the inflow of foreign financial aid; however, it also had an impact on the national economy due to the high cost of the national defence apparatus.

The recent economic agreement with China is a new opportunity for Pakistan: nevertheless, it is a challenging one, considering both the mutating broader regional geopolitical trends and alignments, and the escalating tensions with Washington and New Delhi.

## 2. *Economic growth and challenges*

Pakistan's mounting total external debt and liabilities reached US\$ 61.357 billion in June 2016, about 20% of its GDP.<sup>4</sup> A report of the Economic Affairs Division for the Senate Finance Committee states that from 2005 and 2015, Pakistan obtained loans for more than US\$ 45 billion.<sup>5</sup>

IMF credit<sup>6</sup> is made available under multiple lending/concessional arrangements (Structural Adjustment Programmes) tailored to the beneficiary

1. Benazir Bhutto was Prime Minister in 1988-1990 and in 1993-1996; Nawaz Sharif was Prime Minister in 1990-1993 and in 1997-1999.

2. Akbar Zaidi, *Issues in Pakistan's Economy: A Political Economy Perspective*, Karachi: Oxford University Press, 3<sup>rd</sup> edition, 2015, pp. 3-11.

3. Non-concessional flows and aid for military and anti-terrorism purposes are excluded from ODA.

4. The external debts account for about 30% of the total. ADB - Asian Development Bank, *Basic 2016 Statistics* (<http://www.adb.org>); State Bank of Pakistan, *Pakistan's External Debt and Liabilities - Outstanding* (<http://www.sbp.org.pk>).

5. 'The Peculiar Case of Taxation', *Pakistan Today*, 14 November 2015.

6. A history of Pakistan-IMF relations is provided in Akbar Zaidi, *Issues in Pakistan's Economy*.

countries' balance of payments. These programmes are subject to differing disbursement schedules, maturities, and interest rates.<sup>7</sup> The international financial commitments require beneficiary countries to re-frame their national policies to embrace the core policy measures of the «Washington Consensus» model, which embodies the set of free market economic ideas promoted by the international organisations.<sup>8</sup>

In adherence to the structural changes in the economy required by the international financial assistance, over the last 10 years Pakistan has shown an increasing commitment to enhancing its national macroeconomic stability. At the end of September 2016, Pakistan formally ended a three-year programme with the IMF, an Extended Fund Facility of US\$ 6.6 billion.

The year 2016 marked a modest improvement in Pakistan's economic performance (see table 1).<sup>9</sup> In the fiscal year July 2015 – June 2016, the economic growth rate was 4.5% of the GDP. Although the 5.5% target was missed, an acceleration from the previous year was recorded in the struggle aimed at «steady growth recovery».<sup>10</sup> Accordingly the 2016-2017 budget set an even more ambitious rate of growth for the GDP at 5.7%.<sup>11</sup>

**Table 1: GDP constant prices (% of change), South Asia**

| Country            | 2010 | 2011   | 2012   | 2013  | 2014  | 2015  | 2016 |
|--------------------|------|--------|--------|-------|-------|-------|------|
| <b>Afghanistan</b> | 8.44 | 6.479  | 13.968 | 3.933 | 1.282 | 1.466 | 2.02 |
| <b>Bangladesh</b>  | 6.03 | 6.494  | 6.26   | 6.038 | 6.292 | 6.402 | 6.56 |
| <b>Bhutan</b>      | 9.33 | 10.069 | 6.407  | 4.905 | 6.412 | 7.668 | 8.4  |
| <b>India</b>       | 10.3 | 6.638  | 5.619  | 6.639 | 7.244 | 7.336 | 7.45 |
| <b>Maldives</b>    | 7.17 | 8.709  | 2.499  | 4.698 | 6.479 | 1.912 | 3.55 |
| <b>Nepal</b>       | 4.82 | 3.422  | 4.781  | 4.129 | 5.381 | 3.363 | 0.54 |
| <b>Pakistan</b>    | 2.58 | 3.624  | 3.837  | 3.653 | 4.026 | 4.239 | 4.5  |
| <b>Sri Lanka</b>   | 8.02 | 8.405  | 9.145  | 3.396 | 4.458 | 5.183 | 5    |

Source: IMF, 'World Economic Outlook Database', April 2016 (<https://www.imf.org>).

7. Details of the IMF's schemes are available at the link <http://www.brettonwoodsproject.org/2005/08/art-320868>.

8. John Williamson, *The Washington Consensus as Policy Prescription for Development*, Lecture delivered at the World Bank on 13 January 2004 (<https://piie.com/publications/papers/williamson0204.pdf>).

9. Asad Hashim, 'Pakistan misses GDP growth target by 0.8 percent, sets 5.7 percent target for next year', *Reuters*, 30 May 2016.

10. The World Bank, *Pakistan Development Update. From Stability to Prosperity (English)*, Washington, April 2016 (<http://documents.worldbank.org/curated/en/174441468184172024/Pakistan-development-update-from-stability-to-prosperity-April-2016>) [hereafter quoted as *Pakistan Development Update*]

11. Government of Pakistan, Finance Division, *Federal Budget 2015-16. Budget in Brief* (<http://www.finance.gov.pk>).

As per the IMF's 2015 figures, Pakistan's GDP stands at roughly US\$ 270 billion and ranks 40<sup>th</sup> in the list of the largest world economies (in the total of over 190), being the second largest in South Asia after India. Lists maintained by other international organisations such as the WB (and the UN (United Nations) give similar assessments.<sup>12</sup>

The main reasons for the overall healthy situation of the fragile Pakistani economy in 2016 can be identified as a combination of multiple factors which brought about the containment of the deficit to 0.8% of the GDP and generated an external surplus. Among these factors there are: the reduction of external sector vulnerabilities; the growth in private consumption; high remittances offsetting the trade deficit; and, finally, augmented financial inflows from CSF (Coalition Support Fund).<sup>13</sup>

With the aim of decreasing the fiscal deficit/GDP ratio, Pakistan has placed emphasis on resource mobilisation with subsequent fiscal consolidation measures to increase its tax revenue. Public expenditures have been cut as well, and tariff exemptions and concessions have been reduced. On the monetary side, market interest rates have been eased through cuts of the State of Pakistan Bank's policy rate; liquidity management has been conducted through open market operations by injecting liquidity in the market, and credit to the private sector has expanded.

In 2016, Pakistan's international commitments allowed it to consolidate growth in government expenditures, restraining them to 8.1%; tax revenue grew 20% against an increase in direct and indirect tax collection; efforts were made to boost the supply of electricity and access to credit to improve industrial performance. A progressive accumulation of foreign exchange reserves was also recorded.<sup>14</sup>

The trade sector still faces major challenges. In 2016, exports declined by 11.1%, mainly due to weak performance in the traditionally leading sectors – textiles and foodstuffs.<sup>15</sup> Pakistan's narrow export base, trade facilities and protectionist trade policies constrained the competitiveness of its exports, and the country scored 144<sup>th</sup> (out of 190 countries) in the «doing business» ranking as result of an overall investment climate described as

12. *Ibid.*

13. The CSF foots the costs above the regular military costs, incurred by Pakistan in fighting terrorism. On this see par. 6.2, below.

14. Pakistan's energy sector is challenged by constraints in the supplies of gas and electricity. The World Bank, *Doing Business 2017*, Washington, 2016 (<http://www.doingbusiness.org>).

15. Textile exports account for about 60% of the total exports and fell by 4.5%. About 63% of the Pakistani exports are sold to only a few destination markets: The United States and Europe (the UK, Germany, France, Italy, Spain) comprise approximately one-third of the total (*Pakistan Development Update*).

unfriendly.<sup>16</sup> Favourable oil prices and increasing remittances from overseas continued to counterbalance the decline in exports.<sup>17</sup>

Although the agricultural sector, which is predominant in the total economic output of the country<sup>18</sup>, recorded a setback in 2016, the industrial sector recorded growth to 4.4% from 3.62% in the previous fiscal year.<sup>19</sup> Services expanded as well (5.2% compared with 4.37% in the previous fiscal year), and the inflation rate decreased from 4.5% to 3.3%.<sup>20</sup>

The privatisation of state-owned companies was part of the latest 2013-2016 Pakistan-IMF deal. Under the IMF's Economic Reforms Programme, Pakistan has provided a roadmap for the privatisation of 68 state-owned companies – including Steel Mills, Pakistan International Airlines and State Life Insurance Corporation. Privatisation is a goal of Prime Minister Nawaz Sharif, who believes that it will help Pakistan achieve higher economic growth and further progress in fiscal consolidation. Yet the political implications of the privatisation process have slowed it down, as many of the state owned enterprises are overstaffed, and restructuring would result in severe job losses.

While the growth rate is universally accepted as an essential indicator of good economic performance, the appropriateness of the Structural Adjustment Process in Pakistan has been questioned by many economists and analysts as negatively effecting economic growth.<sup>21</sup> Protracted adherence to debt and consequent dependency on ODA are considered impediments to development, and there are indications that they have prevented distributive and sustainable development. Pakistan ranks 147<sup>th</sup> out of 188 countries in the 2015 HDI (Human Development Index).<sup>22</sup> Pakistan's latest HDI value

16. The ranking includes, *inter alia*, measurement criteria such as the procedures, time and capital to start a business; the procedures, time and cost to connect to the electrical grid; the reliability of the electricity supply; the time for a firm to comply with all tax regulations and tax rates. The World Bank, *Doing Business 2017*.

17. The World Bank, *Personal Remittances, Received (% of GDP)* (<http://data.worldbank.org/indicator/BX.TRF.PWKR.DT.GD.ZS?locations=PK>).

18. Agriculture absorbs 45% of employment and accounts for 20% of the GDP (industry 21%; services 55%). Serhan Cevik, *Unlocking Pakistan's Revenue Potential*, International Monetary Fund Working Paper, 2016, p. 7.

19. *Pakistan Development Update*.

20. The World Bank, *Pakistan - Country Snapshot (English)*, Washington, 2015 (<http://documents.worldbank.org>).

21. Akbar Zaidi, *Issues in Pakistan's Economy*, p. 497.

22. UNDP, *Human Development Report 2015: Work for Human Development*, New York 2015. A new poverty line has recently been adopted which identifies almost 30% of the population – 60 million people – as poor. The declining poverty trend since 2001 has continued according to both the old and the new threshold (from 64% to about 30% between 2001 and 2014). As per the UN MPI (Multidimensional Poverty Index, which measures poverty as the result of multiple deprivations in education, health and living standards), in Pakistan, 45.6% of the population are multidimensionally poor, while an additional 14.9% live near multidimensional

is 0.538. While this is above the average of countries with low human development, the measurement of the «loss» in human development due to inequality places Pakistan below the South Asian average.<sup>23</sup>

### 3. Fiscal consolidation

The collection of revenue has remained flat for most of the last decade, resulting in an insufficient amount of wealth being mobilized and put to collective use, which has contributed significantly to the fragility of Pakistan's economy.

Fiscal consolidation was the *sine qua non* requested by the IMF for its support. A full-fledged policy to tackle tax evasion has yet to be introduced, although measures required by the international loans have been taken to comply with the reform process.<sup>24</sup> Sharif's government is committed to fiscal discipline, and measures taken in the areas of tax administration and the elimination of tax exemptions have succeeded in increasing the tax-to-GDP ratio. In fact, in 2016 it has increased by over 60% in nominal terms (or 2.4% of GDP) over the past three years to 12.4%.<sup>25</sup> Yet it remains significantly below those of comparable emerging market economies, and as per the IMF's estimates, it is below the country's 22.3% capacity.<sup>26</sup>

Pakistan faces long-term challenges in collecting taxes. The taxation system relies mostly on indirect taxes collected from a very narrow tax basis due to the way tax liabilities are determined. IMF data for 2016 show that indirect taxes account for roughly 65% of the total tax revenue. Direct taxes, which have increased modestly since the 1990s (from less than 20% to, more recently, 35%-38% of the total tax revenue), are still 55% lower than those of other comparable economies and are mostly collected from businesses. The current level of income taxes in Pakistan – roughly a quarter of the total revenue – is 4% of its GDP.<sup>27</sup> Over 70% of the total tax revenue is collected mostly from industry, salaried workers, and the services sector. The latter, particularly finance-related and telecommunications, remains the main contributor to growth, accounting for more than 50% of the GDP in fiscal year 2015-2016.<sup>28</sup>

poverty. The latest MPI's value of Pakistan is 0.237. The Pakistan's Gini coefficient, which measure the deviation of the distribution of income within a country (a value of 0 represents absolute equality, a value of 100 absolute inequality) is 29.6 (<http://hdr.undp.org/en/countries/profiles/PAK>).

23. UNDP, 'Human Development Report 2015. Briefing Note for Countries' ([http://hdr.undp.org/sites/all/themes/hdr\\_theme/country-notes/PAK.pdf](http://hdr.undp.org/sites/all/themes/hdr_theme/country-notes/PAK.pdf)).

24. 'Pakistan's Taxation Crisis', *Dawn*, 7 August 2015.

25. Serhan Cevik, 'Unlocking Pakistan's Revenue Potential'.

26. *Pakistan Development Update*.

27. Serhan Cevik, 'Unlocking Pakistan's Revenue Potential'.

28. 'Pakistan: Tax Regulations', *Views Wire*, 31 October 2015; *Pakistan Development Update*.

The administration of the Pakistani tax system is prescribed by the Constitution, which assigns it to both the federal and the provincial governments. The latter have authority over specific economic sectors, while more than 90% of the tax revenue is collected by the federal government, with the provinces relying on transfers of the shared revenue from the central authorities.<sup>29</sup> The 18<sup>th</sup> Constitutional Amendment (2011-12) has devolved several federal competencies to the provinces, along with a greater share of revenue (57.5%).<sup>30</sup> Yet the decentralisation process has posed effectiveness-related challenges in terms of service delivery and low capacity at the provincial level to generate revenue, due to widespread tax concessions and exemptions.

The agricultural sector contributes minimally to the total tax revenue. Taxes on agricultural income are based on the land size, and land holdings are tax exempted when they are smaller than 12.5 acres, which is the case for the overwhelming majority of holdings in Pakistan.<sup>31</sup> Similar concessions and exemptions are also granted to exporting companies and foreign companies, which are taxed at the same rates as local companies.

The widespread informal economy and income underreporting are additional challenges to tax compliance and enforcement.<sup>32</sup> Tax avoidance and evasion occur on a large scale among both individuals and companies. As mentioned above, most of the taxes are collected from businesses, with less than one-third of registered companies paying income taxes.<sup>33</sup> The number of people registered for Personal Income Tax has almost quintuplicated in the last 15 years (3.6 million in 2014), but it is still inadequate when compared to the 32 million people employed in sectors other than the agricultural sector.<sup>34</sup>

29. Agriculture, services and immovable property. See Serhan Cevik, 'Unlocking Pakistan's Revenue Potential', p. 5.

30. The World Bank, *Pakistan - Country Snapshot (English)*.

31. The agricultural sector generates less than 0.1% of the total tax revenues, although as mentioned above, it accounts for about 20% of the GDP and employs 45% of the workforce at the national level. Serhan Cevik, 'Unlocking Pakistan's Revenue Potential', p. 7.

32. 'The Peculiar Case of Taxation', *Pakistan Today*, 14 November 2015.

33. Serhan Cevik, 'Unlocking Pakistan's Revenue Potential', p. 7.

34. The Income Tax Ordinance 2001 grants confidentiality to the taxpayers' records and prohibits their disclosure. Reference is made to the data of the Federal Board of Revenue and of the State Bank of Pakistan ([www.fbr.gov.pk](http://www.fbr.gov.pk); <http://www.sbp.org.pk>), of the IMF (quoted in Serhan Cevik, 'Unlocking Pakistan's Revenue Potential'), of the Research and Advocacy for the Advancement of Allied Reforms (RAFTAAR, <http://www.raftaar.pk>) and of the EIU ('Pakistan: Tax Regulations', *EIU Views Wire*, 1 November 2006).

#### 4. *The cost of defence*

Pakistan's efforts to strengthen its internal defence capabilities have resulted in increasingly high resource allocations to the military sector. Following the trend of recent years, the 2016-2017 federal budget raised the defence allocation from US\$ 7 billion in the previous fiscal year to US\$ 8.3 billion<sup>35</sup>, or 3.6% of the GDP<sup>36</sup> and about 18% of the total annual outlay.<sup>37</sup>

With a share of 47% of the total funds allocated to defence, the Army is the main recipient, while the Air Force and the Navy receive 20% and 10%, respectively, and the Ministry of Defence receives the remaining funds. About the 40% of the defence budget is for employee-related expenses, 25% for operating expenses and a similar amount for physical assets.<sup>38</sup> Social welfare-related costs for military personnel and their families are not part of the defence budget. The nuclear programme and the cost of the military operations underway in the North West of the country (see par. 5.2) are also not included (the former has a development budget from the Pakistan Atomic Energy Commission). The CSF (see. par. 6.2) makes available the equivalent of about 20% of the defence budget, and the contingent liability can mobilise another similar amount.<sup>39</sup>

While the available data do not provide a breakdown of the costs of the control of the anti-government armed militancy compared to the arms race with India and the maintenance of forces on the eastern border, it is a fact that tackling anti-government militancy has necessitated increasing military operations in the last decade (see paragraph 5.2).<sup>40</sup>

35. In the fiscal years 2013-2014 and 2014-2015, the defence allocation passed from US\$ 6 to 6.9 billion to then being overspent by almost US\$ 200 million. Government of Pakistan, Finance Division, *Federal Budget. Budget in Brief*, <http://www.finance.gov.pk>.

36. Military expenditures in Pakistan, as a percentage of central government expenditures, decreased from 7.26% in 1988 to 3.27% in 2015. The World Bank, *Military Expenditure (% of GDP)*, <http://data.worldbank.org/indicator/MS.MIL.XPND.GD.ZS>.

37. 'Defence Budget', *The News*, 12 June 2016.

38. This aspect is addressed by Ayesha Siddiqi, *Military Inc.: Inside Pakistan's Military Economy*, London and Karachi: Oxford University Press, 2007.

39. «Contingent liabilities» are possible future liabilities that will only become certain on the occurrence of some future event and do not appear on the balance sheets ('Pakistan's New Military Budget: By the Numbers', *The National Interest*, 5 July 2015; '11% Hike in Defence Budget Maintained', *The Express Tribune*, 4 June 2016; 'Defence Budget Hiked by Usual 11pc', *Dawn*, 4 June 2016; Government of Pakistan, Finance Division, *Federal Budget 2016-17. Budget in Brief*, Islamabad, 2016 ([http://www.finance.gov.pk/budget/Budget\\_in\\_Brief\\_2016\\_17.pdf](http://www.finance.gov.pk/budget/Budget_in_Brief_2016_17.pdf)).

40. A list of large-scale military operations conducted in Pakistan's northern areas and targeting local and foreign militants between 2001 and 2014 is available at 'Comparing Pakistan's Past Military Operations with Operation Zarb-e-Azb - PKKH.

Terrorism has negatively impacted Pakistan's economic growth in terms of resource reallocation, military expenditures, and the contraction of trade, business activities, and investments at large.<sup>41</sup> The economic impact of terrorism as a percentage of GDP is estimated as 2.8%.<sup>42</sup> The *Zarb-e-Azb* military operation launched in 2014 has contributed to improving the security situation in the North West of the country (see. par. 5.2). The 2015-2016 Economic Survey of Pakistan acknowledged the critical role played by the intervention of the army toward creating an environment conducive to business and investment, as shown by the declining direct and indirect economic losses, resulting from the militancy.<sup>43</sup>

## 5. Domestic affairs

### 5.1. Panama Papers

The description of Pakistan's overall taxation system and its features provides the background of the Panama Papers scandal that hit Pakistan and its Prime Minister in 2016.<sup>44</sup> It originated from a massive leak of files from a Panama-based law firm, Mossack Fonseca, one of the world's biggest providers of offshore services. The records, obtained by the German newspaper *Süddeutsche Zeitung*, were then shared with the International Consortium of Investigative Journalists, and, subsequently, with their network of international partners, including the Guardian and the BBC (British Broadcast Corporation).

The documents reveal the names of globally known VIPs who have been exploiting offshore tax havens. Among these VIPs, over 200 are from Pakistan and include politicians and their relatives. Among them there are: family members of Pakistan's Prime Minister Nawaz Sharif; relatives of Shahbaz Sharif, Nawaz's brother; the chief minister of Punjab, former ministers, senators, etc.

The allegations against Sharif's family refer to controlled shell companies (Nescoll Ltd, Nielsen Enterprises Ltd and Hangan Property Holdings Ltd, incorporated in 1993, 1994 and 2007, respectively) through which

tv', *Pakistan Defence*, 12 August 2014 (<https://defence.pk/pdf/threads/comparing-pakistans-past-military-operations-with-operation-zarb-e-azb-pkhh-tv.328771>).

41. Shabir Hyder, Naeem Akram, Ihtsham Ul Haq Padda, 'Impact of Terrorism on Economic Development in Pakistan', *Pakistan Business Review*, January 2015, pp. 704-722, available at <http://www.iobm.edu.pk/wp-content/uploads/2015/03/Naeem-Akram.pdf>.

42. Institute for Economics and Peace, *Global Terrorism Index*, 2016, (<http://economicsandpeace.org>).

43. Ministry of Finance, *Economic Survey 2015-2016* (<http://www.finance.gov.pk>).

44. The International Consortium of Investigative Journalists, *The Panama Papers* (<https://panamapapers.icij.org>).



Nawaz's daughter and two of his sons had acquired real estate companies in London.

Holding offshore companies is not illegal in Pakistan, yet it has been asserted that Sharif family's offshore bank accounts contain money gained by corrupt practices when Nawaz's political career was rapidly ascending.<sup>45</sup>

There were tenacious calls for Sharif's resignation, based on alleged violations of Articles 62 and 63 of the Constitution, which regulate the disqualification of members of the Parliament. These calls were made by multiple parties, among which the PTI (*Pakistan Tehreek-e-Insaaf*) – whose chairman, Imran Khan, admitted he had also used an offshore company for tax avoidance purposes – and the PAT (Pakistan Awami Tehreek). In November 2016, the PTI organised a large sit-in protest in Pakistan's capital, Islamabad. The planned protest formed part of an ongoing campaign against government corruption, and was aimed at seeking Sharif's resignation. In response, the authorities issued a directive banning rallies in Islamabad and the neighbouring city of Rawalpindi for two months, and clashes occurred between police and protesters. Khan called off his protest campaign only after the Pakistan Supreme Court announced the decision to form a commission to investigate corruption.

Facing calls for his resignation, Sharif denied any wrongdoing and expressed his willingness to form a judicial commission to clear his family's reputation. He described the accusations against him as the work of the detractors who were targeting him and his family for political reasons and said he would resign if found guilty. Nevertheless, he was put under significant pressure. The same has occurred to General Shar Raheel Sharif, the country's top Army officer, who retired at the end of November 2016. He was replaced by General Qamar Bajwa, who was supposed to restore «across-the-board accountability» and who, indeed, took the unprecedented step of disclosing the names of a group of senior Army officers who had been found guilty of corruption.

## 5.2. *Armed militancy and terrorism, and the fight against them*

The turning point in the fight of the Pakistan State against armed militancy and terrorism can be considered the *Zarb-e-Azb* military operation, which was launched in June 2014 against the TTP (Tehrik-i-Taliban Pakistan, an alliance of a dozen of insurgent groups). It was the response to the attack at the Karachi's Jinnah International Airport, which had showed that Sharif's attempts to hold peace talks with the militants had been fruitless.<sup>46</sup>

45. In the mentioned period, Nawaz Sharif was the finance minister of Punjab from 1981 to 1985; Punjab's chief minister from 1985 to 1990; prime minister of Pakistan (between 1990-1993).

46. Marco Corsi, 'Gli Attacchi al Governo di Sharif e le Tensioni con i Militari', *Asia Maior 2014*, pp. 370-373.

The military intervention was widely supported by the political parties and civil society at large. This support became starkly more pronounced after the TTP attack on the Army Public School in Peshawar in December 2014, during which 139 people, mostly students and teachers, were killed.<sup>47</sup> An action plan was announced by the government pursuant to which security forces and intelligence agencies were to conduct joint anti-terrorism operations.

Since then, operations have been conducted against militant outfits across the country in the Khyber Pakhtunkhwa, Punjab, Sindh and Baluchistan provinces, and in the FATA (*Federally Administered Tribal Areas*). Security forces have regained control over the areas which were the most volatile before the Army operations, particularly Khyber and North Waziristan Agencies, Miranshah, Mirali and Tirah valley. Nawaz Sharif and Chief of Army Staff General Raheel Sharif have repeatedly reaffirmed their intention to eradicate extremism from Pakistan.<sup>48</sup>

In 2016, TTP and its splinter factions showed their willingness and capacity to carry out attacks against «soft targets». These attacks, however, were fewer in number than in the previous years.

An educational establishment was again stormed on 20 January 2016: The Bacha Khan University campus in Charsadda, about 30 km from Peshawar, was attacked, leaving 21 dead and 35 injured among the students and professors.<sup>49</sup>

On 27 March 2016, more than 70 people were killed and about 300 wounded when a suicide bomber detonated himself in the crowded Gulshan-e-Iqbal Park in Lahore during Easter celebrations.<sup>50</sup> The splinter group of the Pakistani Taliban Jamaat-e-Ahrar claimed responsibility for the explosion, specifying that the target of the killings was the Christian community.<sup>51</sup> The bombing came as protests were held in Pakistan against the execution on 29 February 2016 of Malik Mumtaz Hussain Qadri, the police

47. Marco Corsi, 'Domestic and Foreign Policy Challenges', *Asia Maior 2015*, pp. 445-447.

48. Military operations coincided with a decline in terrorism in Pakistan. In 2015, Pakistan recorded a substantial drop in terrorist activity with 45% fewer attacks and 38% fewer deaths than in the previous year. Terrorism in the country is now at its lowest level since 2006. However, although the number of attacks has fallen, terrorism in Pakistan is geographically spreading. It has moved from the border region with Afghanistan and is now present in many other parts of the country, especially in the Punjab province (Institute for Economics and Peace, *Global Terrorism Index*).

49. 'Taliban Attack at Bacha Khan University in Pakistan Renews Fears', *The New York Times*, 20 January 2016; 'Terrorists Hit Bacha Khan University', *The News International*, 21 January 2016.

50. 'Blast at a Crowded Park in Lahore, Pakistan, Kills Dozens', *The New York Times*, 28 March 2016.

51. Jamaat-ul Ahrar broke away from the TTP in 2014 after the latter entered talks with the Pakistani Army. The group, which has professed allegiance to the Islamic State, also claimed responsibility for the 15 March 2015 attacks on two churches in Lahore (Marco Corsi, 'Domestic and Foreign Policy Challenges').

guard who had been found guilty of the murder of the former governor of Punjab, Salmaan Taseer. Mr. Taseer had called for the reform of Pakistan's blasphemy laws, as he considered them to be a tool used to persecute religious minorities.

The Lashkar-i-Jhangvi, a militant group having connections with the Islamic State (IS), claimed responsibility for the raid perpetrated against a police training college on 24 October 2016 in Quetta, the capital city of the Balochistan province, during which over 60 cadets were killed.<sup>52</sup>

The Shah Bilal Noorani Sufi shrine in the Khuzdar district of the Balochistan province was targeted by militants, with a suicide bomber killing dozens of people on 10 November 2016. The media reported that IS claimed responsibility for the attack, yet police officials believed it could be the responsibility of an anti-Shiite militant group – Jundullah – in retaliation for killing the group's leader by paramilitary troops.

Since the beginning of 2016, the Pakistani military has intensified its military operations in Balochistan, a vast territory boasting reserves of gas, gold, copper, and untapped sources of oil and uranium. Islamabad's exploitation of natural resources in the area and the Baloch population's resistance to it have led to multiple armed uprisings in the region since Pakistan annexed the territory in 1948. In April 2016, the paramilitary forces of the Frontier Corps launched a search for guerrillas from the BLA (Balochistan Liberation Army), a militant organisation. It is believed that the main purpose of the operations in Balochistan is to crush any resistance against the implementation of the China-Pakistan Economic Corridor (see par. 6.1). In fact, the Baloch nationalist groups have opposed the project, as they perceive it as a further step towards making their ethnic group into a minority in their own homeland.

In April operation *Zarb-e-Aahan* was launched in the Punjab by the military to fight a group of bandits who had kidnapped 24 police officers. The operation ended successfully on 20 April with the unconditional surrender of the surviving members of the band and the liberation of the hostages.<sup>53</sup>

## 6. Foreign policy

### 6.1. The China-Pakistan Economic Corridor

Since autumn 2013 China has launched an ambitious foreign development economic initiative, aimed at recreating the trade connections that,

52. 'Pakistan Reels After Attack on Police Training College Leaves 61 Dead', *The New York Times*, 25 October 2016.

53. 'Chotoo, gang members surrender unconditionally to army: ISPR', *Dawn*, 20 April 2016.

in antiquity, related China to the Mediterranean world. This «Silk Road Economic Belt» and its overseas version, the «Maritime Silk Road», consist in a series of projects aimed at connecting the East Asian nation to Central Asia and Europe. The initiative, formerly called OBOR (One Belt, One Road) and, more recently BRI (Belt and Road Initiative), reached Pakistan under the framework of the China-Pakistan Economic Corridor (CPEC). In 2015, China pledged US\$ 46 billion in support for energy and infrastructure projects to be implemented in Pakistan. In 2016, the size of the financial support to project escalated to US\$ 51,5 billion, thanks also to help of the Asian Development Bank.<sup>54</sup> According to the CPEC plan, an economic corridor will connect the Pakistani port of Gwadar in Balochistan, which has been financed and constructed by the Chinese on the shores of the Arabian Sea, to Kashgar, in the Muslim majority Xinjiang region of China. The CPEC will include land routes (3,000 km of road and rail infrastructure worth more than 10 billion US\$) and a network of gas pipelines extending beyond Pakistan to Iran. In addition to the development of a trade and transport route from Kashgar in China to Gwadar Port, CPEC also envisages the development of special economic zones and projects aimed at attracting Chinese investments. The goal is the construction of nuclear, hydropower, solar, and coal plants which are expected to boost Pakistan's energy capacity.

Gwadar Port is of strategic interest to China, both economically and militarily.<sup>55</sup> Economically it grants access to the Gulf countries; militarily it gives China the possibility to establish a naval base on the Arabian Sea. The port will also play a critical role for Pakistan, particularly with respect to both the outflow of goods from Western China and Central Asia, and the charges – for the port, cargo handling, and freight – that will be earned.

The CPEC agreement is a potential game-changer for Pakistan, given its unprecedented economic dimensions and strategic importance, potentially overtaking the importance of the connection with Washington. In 2016 the concrete possibility took shape that Pakistan could leave the US orbit, just when its market appeared at take-off stage and the country was considered a possible next emerging economy.

Due to the CPEC, in the year under review China was the most important partner of Pakistan in terms of FDI (Foreign Direct Investments). In 2016, the funds injected into the Pakistan monetary system by the CPEC investments provided a remarkable increase (US\$ 2.5 billion) in Pakistan's official reserves. The State Bank of Pakistan revealed that the inflow of

54. Khaleeq Kiani, 'With a new Chinese loan, CPEC is now worth \$51.5bn', *Dawn*, 30 September 2016.

55. The proximity of the port to the Persian Gulf provides China with the shortest route to the Middle East, Africa, and most of the Western hemisphere. 'Balochistan: The Troubled Heart of the CPEC', *The Diplomat*, 23 August 2016.

FDI, mostly attributable to China, had increased by 38.85%.<sup>56</sup> On their part, the IMF CPEC-related capital inflows (FDI and external borrowing) were estimated at about 2.2% of the projected GDP in FY2019/20.<sup>57</sup>

Balochistan – namely an area crucial for the successful completion of CPEC – is the largest and poorest province in Pakistan and is rich in natural resources. Baloch nationalists have accused the federal government of the exploitation of the province's wealth and the violation of its rights. As a consequence, the development of the Gwadar Port – the linchpin of the «Maritime Silk Road» – has proceeded in parallel with an upsurge in extremism in the province. Baloch political parties have opposed the deal with China, and Baloch militant organisations have sabotaged the construction work.

The government of Pakistan has shown its commitment to supporting the smooth development of the CPEC project, and has promised to protect CPEC workers and investments by deploying ad hoc troops. In fact, the growing terrorism in Pakistan is a major concern for the Chinese authorities. Islamabad has repeatedly accused India of fomenting terrorist activities and of establishing training camps for Baloch separatists in Afghanistan, to demotivate China and obstruct the CPEC project.

## 6.2. *The Pakistan - USA relations*

Pakistan became a frontline state in the Afghan war against Soviet occupation (December 1979 - February 1989) and in the post-9/11 «war on terror». In both cases, Pakistan was an essential ally of the United States and a major recipient of US foreign aid. Between the two conflicts, Pakistan was sanctioned multiple times by the United States due to its nuclear programme, and in 1999, because of the military coup which brought Pervez Musharraf to power.

The post-9/11 events offered an unprecedented opportunity to Pakistan, when it undertook counterterrorism operations jointly with the United States. The Congress of the United States lifted most of the economic sanctions imposed on Pakistan, and the government of Islamabad was able to reconnect with the international community and had the chance to re-affirm the country's international reputation.

Until recently, the United States' military aid to Pakistan has been the largest component of US aid to the country. Since the aftermath of the 9/11

56. Countries other than China have not made a significant contribution to the growth in FDI, except for the United Arab Emirates, Hong Kong, and Italy. FDI has declined in the fiscal year 2015-2016, particularly that from the United Kingdom and the United States. The reason for this decline is the existence of an environment unfavourable to business as mentioned above. See 'Pakistan needs to look beyond China for FDI', *East Asia Forum*, 15 August 2016.

57. M.K. Bhadrakumar, 'CPEC bee in Indian bonnet buzzes western tunes', *Indian Punchline*, 7 November 2016.

attacks, the US has provided most of its disbursements through the Coalition Support Fund, which adds to the resources already allocated to defence by Pakistan's annual budget. The CSF was conceived to support the costs above the regular military costs, incurred by Pakistan in fighting terrorism. It allowed Islamabad's government to be reimbursed and compensated, respectively, for military expenses incurred and for the support made available to the coalition forces.<sup>58</sup> Out of a total amount of US\$ 33 billion, inclusive of security and economic-related disbursements, the United States has reimbursed approximately US\$ 14 billion to Pakistan under the CSF from 2002 to 2016.<sup>59</sup>

Since the end of the last decade, the United States has been reconsidering its assistance to Pakistan. The decline in the United States' assistance was partially due to a lack of confidence in Pakistan's commitment to fighting terrorism. The turnover at the White House in 2009 marked a progressive disengagement of the United States in Afghanistan and the establishment of new broader regional geopolitical trends and alignments. Military reimbursements were also temporarily frozen in 2011 (but resumed later that year), following the bilateral fallout after the United States' raid against Osama bin Laden's compound in Abbottabad. The *Enhanced Partnership with Pakistan Act* of 2009 committed US\$ 7.5 billion in non-military aid over a 5-year period, followed by a US\$ 2 billion military aid package the following year.<sup>60</sup> In 2016, civilian and military aid to Pakistan was less than US\$ 1 billion, the lowest allocation since 2007.<sup>61</sup>

Counterterrorism and international security were discussed by Pakistan's Advisor to the Prime Minister on Foreign Affairs Sartaj Aziz, and United States Secretary of State John Kerry on 29 February 2016, in Washington, when they convened the sixth ministerial-level Pakistan-U.S. Strategic Dialogue.<sup>62</sup> Yet bilateral relations became tense after a Taliban leader, Mullah Akhtar Mansour, was killed on 21 May 2016 in a United States' drone attack in Balochistan, a province off limits to American air strikes. The acrimony worsened when the United States Department of Defence decided to withhold a US\$ 300 million tranche of military reimbursement payments, citing Pakistan's inadequate attention to the deadly Haqqani network terror group.<sup>63</sup>

58. CSF is not foreign assistance. Yet some sources have mentioned that Pakistan has been under-compensated by the CSF, as it has limited reimbursements to the costs of military operations only. See Akbar Zaidi, 'Issues in Pakistan's Economy', p. 754.

59. Susan Epstein, Alan Kronstadt, *Pakistan: U.S. Foreign Assistance*, CRS, July 2013 (<https://fas.org>; <http://www.cgdev.org>).

60. Akbar Zaidi, 'Issues in Pakistan's Economy', p. 766.

61. 'US Assistance to Pakistan Set to Fall to Lowest Level Since 2007', *The Diplomat*, 27 August 2016.

62. 'U.S.-Pakistan Strategic Dialogue Joint Statement', 29 February 2016 (<http://www.state.gov/r/pa/prs/ps/2016/03/253857.htm>).

63. 'US May Suspend 300 Million Military Reimbursement for Pakistan', *The Diplomat*, 5 August 2016.

In Pakistan there is the perception that both India and the United States are opposing BRI due to its geo-strategic implications. This perception is grounded on the convergence of India's foreign policy in the Asia-Pacific region (the «Act East Policy») with the US's anti-China arc of containment policy, originating from the so-called «Asia Pivot», the strategic rebalancing of the United States' interests towards East Asia. In short, the United States would support India's «Act East» policy and would oppose China's BRI, as a weaker China would be functional to the success of the US hegemonic aims in Asia.

In this overall context, the United States Congress's concerns regarding human rights violations in the poor and populous province of Balochistan, the linchpin of the CPEC project, and accusations by the House of Representative's Committee on Foreign Affairs that Pakistan's military has used American arms against the Balochi population have been considered by Pakistan as having the geo-political strategic purpose of balancing China by backing India as its competitor.<sup>64</sup>

### 6.3. *The Pakistan – India relations*

India has reacted to the increasingly strict Pakistan-China connection by strengthening its own relations with the ASEAN countries under the «Act East» policy,<sup>65</sup> and by searching an access to Central Asia that bypasses Pakistan. In May 2016, India, Iran, and Afghanistan reached a trade agreement which gives India access to Central Asia from Chabahar, a port located in South Western Iran and just a few kilometres away from Gwadar. Although a convoluted one, this route will provide India with access to Central Asia and Russia through Iran.

The year 2015 ended with an attempt to launch a peace dialogue between India and Pakistan with the two Prime Ministers, Nawaz Sharif and Narendra Modi, meeting in Paris on 30 November 2015 and in Lahore on 25 December 2015. However, 2016 was characterised by escalating tensions between the two nations. On 2 January 2016, an armed group wearing Indian Army uniforms attacked the Indian Pathankot Air Force Station in the Indian Punjab. The gun battle and the military operation which was launched subsequently by the Indian military continued up to 4 January and left seven Indian soldiers and six militants dead. The attackers were suspected of belonging to JeM (Jaish-e-Mohammed), an Islamist militant group which has been carrying out attacks in the Indian-administered part of Kashmir, and it is believed to have ties with the Tehrik-i-Taliban Pakistan

64. The United States rejected allegations of its involvement with India in conspiracies against CPEC. See 'United States Rejects Anti CPEC Accusations', *The Tribune*, 8 September 2016.

65. Government of India, Ministry of External Affairs, *Act East. India's ASEAN Journey* (<http://www.mea.gov.in>).

and Al-Qā'ida. Evidence was found linking the attackers to Pakistan, yet Indo-Pakistani joint investigations concluded that there was no evidence of Pakistani involvement.

Following the events of Pathankot, several JeM members were arrested. The initiative seemed to confirm the firmness of the counterterrorism efforts launched by Pakistan in 2015 with the National Action Plan, and was also welcomed by New Delhi as a sign of Pakistan's commitment to avoid the derailment of the peace process.<sup>66</sup> Following the attack, India refrained from indulging in allegations and accusations regarding Pakistan even before the investigations had been launched. Yet the incident led to a breakdown in the India-Pakistan dialogue process.

In July 2016, Indian forces in Kashmir killed Burhan Wani, a young militant separatist who belonged to Hizbul Mujahideen, a pro-Pakistan Kashmiri separatist group. Following his death, protests by the Kashmiri population erupted in the valley, which led to heavy clashes with Indian forces and the establishment of a generalised and indefinite curfew which went on for months. These events led to the further deterioration of Islamabad-Delhi relations, with Pakistan declaring Wani a martyr and bringing up the issue of the Kashmir violence at the UN's Human Rights Council, while reiterating the right of the Kashmiri people to self-determination.

While the Kashmir Valley was at the centre of unrest, in September 2016 armed terrorists attacked an Indian Army installation in Uri, situated in the Baramulla district of Jammu and Kashmir near the LoC (Line of Control). The long gun battle which followed led to heavy casualties among the Indian soldiers. Lashkar-e-Taiba, a militant outfit formally banned in Pakistan and previously involved in the 2001 Indian Parliament and 2008 Mumbai attacks, claimed responsibility for the operation, while JeM was also suspected of being involved.

The Uri attack triggered a serious bilateral crisis between Pakistan and India, and actual hostilities eventuated. The frequency and the intensity of the cross-border gunfights between the two armies intensified, and «surgical army strikes» were reportedly carried out by the Indian army against the militants' training camps located in Pakistani territory. This was a controversial issue; in condemning the «unprovoked aggression» of Indian forces which had resulted in casualties among Pakistani soldiers, Nawaz Sharif rejected any involvement of Pakistan in the Uri attack and referred to a ceasefire violation across the LoC with no actual infiltration of Indian military forces. Exchanges of fire across the LoC continued until the end of 2016, as did the tension between the two countries, which expelled each other's diplomats based on alleged espionage activities.

66. 'India, Praising Arrest of Militants, to Restart Talks with Pakistan', *The New York Times*, 12 January 2016; 'Pakistan Arrests Leaders of Banned Militant Group Ahead of Talks with India', *pakistannews.net*, 13 January 2016.