

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

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ISSN 2385-2526

ISBN 978-88-3313-044-6 (paper)

ISBN 978-88-3313-045-3 (e-book)

Annual journal - Vol. XXVIII, 2017

Published jointly by Associazione Asia Maior & CSPE - Centro Studi per i Popoli extra-europei "Cesare Bonacossa" - Università di Pavia

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Paper version	Italy	€ 50.00	Abroad	€ 65.00
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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. XXVIII / 2017

Asia in the Waning Shadow of American Hegemony

Edited by

Michelguglielmo Torri, Elisabetta Basile, Nicola Mocci

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Marco Corsi

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In July 2017, following his family's involvement in the Panama Papers scandal, Nawaz Sharif was disqualified and ousted from the prime ministership by a Supreme Court decision. The ruling party, the PML-N (Pakistan Muslim League - Nawaz), appointed the Petroleum and Natural Resources Minister, Shahid Khaqan Abbasi, as premier to serve until the elections in 2018.

In the year under review, marking 70 years of independence of Pakistan, national economic growth was recorded at 5.3% of GDP. This marked the highest rate in a decade, confirming the positive trend since 2013. Pakistan's economic performance received plaudits from the international financial organisations and influential rating agencies. However, the International Monetary Fund warned about the re-emersion of macroeconomic vulnerabilities. Also several analysts pointed out that the expected dividends from the CPEC (China Pakistan Economic Corridor) will accrue less to Pakistan than to China.

Bilateral relations of Pakistan with neighbouring Afghanistan deteriorated over reciprocal accusations of state support to infiltrating militants, which triggered a border dispute in April 2017.

The fall of Sharif came as the USA was finalising its strategy on Afghanistan which was then presented in August 2017. It marked a new approach on how Washington intends to deal with Pakistan, characterised by zero tolerance for safe havens for militant organisations.

Pakistan became a member of the Shanghai Cooperation Organization with beneficial prospects in terms of enhanced access to natural resources and trade opportunities.

1. Introduction

After the mild but steady growth recorded since 2010, in 2017 Pakistan's GDP grew from 4.7% the previous year to 5.3% (the highest rate in ten years).¹ In 2016, Pakistan was proclaimed the top-performing market in Asia, and South Asia's second-largest economy was hailed globally by international financial organisations and experts for its accelerating performance.²

1. The International Monetary Fund, 'World Economic Outlook Database', April 2017.

2. Marco Corsi, 'Pakistan 2016: Economic features', *Asia Maior 2016*, p. 388.

Between 2013 and 2016, Pakistan's government implemented an ambitious economic reform programme. The three-year-long International Monetary Fund-supported EFF (Extended Fund Facility) programme, completed in September 2016, strengthened Pakistan's macroeconomic stability and increased consumer confidence.³

In the year under review, that progress has stalled and internal and external balances deteriorated. One year after EFF's successful completion, several of the macroeconomic indicators that improved under the programme weakened, and the International Monetary Fund (IMF) warned of the re-emergence of Pakistan's macroeconomic vulnerabilities.⁴

In 2017, Pakistan's high current account deficit reached US\$ 12.1 billion, a 149% increase since the end of the previous fiscal year. Compared with the same period in 2016, Pakistan's imports increased to 14.2% while exports declined to 1.2%, continuing a trend that began in 2015.⁵

Pakistan's foreign currency reserves – which are built upon exports and foreign borrowing – decreased from US\$ 18.06 billion at the end of June 2016 to US\$ 13.8 billion by the end of October 2017, while debt servicing increased from 2013 to 2016 as the result of borrowing.⁶

The fiscal deficit for the first half of fiscal year 2017 stood at 2.4% of GDP, 0.6% higher than the same period the previous year.⁷

From fiscal year 2016 to fiscal year 2017, Pakistan's FDI (Foreign Direct Investments) prospects weakened, with an increase from US\$ 2.30 billion to US\$ 2.41 billion – an almost irrelevant net inflow as a percentage of GDP – merely reflecting growing Chinese investor confidence.⁸

One year before the 2018 general elections, Pakistan entered an institutional crisis triggered by the investigation into Nawaz Sharif's family corruption charges. The upcoming elections seemed to affect reform momentum and macroeconomic policy orientation. The government appeared inclined to downplay the threat posed to Pakistan's economic stability as economic reforms slowed down.

3. Consumption was 92% of GDP in fiscal year 2016 as documented by The World Bank, *Pakistan Development Update, Growth: A Shared Responsibility*, May 2017.

4. The International Monetary Fund, *Pakistan: 2017 Article IV Consultation - Press Release; Staff Report; Informational Annex; and Statement by the Executive Director for Pakistan*, Washington, July 2017.

5. 'Pakistan Economy In Crisis: Enormous CAD In Financial Year 2017', *Value Walk*, 22 July 2017; 'Pakistan Development Update'.

6. State Bank of Pakistan, *Foreign Exchange Reserves*, (<http://www.sbp.org.pk/ecodata/FER/2017/Forex-20-Oct-17.pdf>); Ministry of Finance, *Economic Survey 2016-2017* (<http://www.finance.gov.pk>).

7. Marco Corsi, 'Pakistan 2016: Economic features', pp. 390-391.

8. 'Pakistan: 2017 Article IV Consultation'.

2. Panamagate: the disqualification of Nawaz Sharif

The Panama Papers scandal, or «Panamagate», originated in 2016 from a leak of files from a Panama-based provider of offshore services, Mossack Fonseca.⁹ Among the names of VIPs who have been benefitting from offshore tax havens, the conspicuous group of Pakistani nationals included family members of Pakistan's Prime Minister Nawaz Sharif. Mr. Sharif's name doesn't appear in the Panama Papers, but three of his six children – Maryam, Hasan and Hussain – were found having purchased luxury properties in London using controlled offshore shell companies. While Nawaz's children maintained that the companies were set up with legally obtained money, prosecutors accused them of having laundered money gained by corrupt practices.

Since his family's involvement in the scandal in April 2016, Sharif's resignation was called for from multiple quarters. Imran Khan, leader of the PTI (*Pakistan Tehreek-e-Insaf*), led the charge against Mr. Sharif through street agitation and court petitions. According to Khan, Sharif had to be disqualified from parliament and resign from his office because of his alleged violations of Articles 62 and 63 of the constitution, which regulate the eligibility and the disqualification of members of parliament.¹⁰

Sharif alleged a conspiracy against him, denying any wrongdoing. He described leaks as the politically-aimed work of his detractors, and warned about the destabilisation his disqualification would trigger at a time when the economy was growing.

In 2016, the Supreme Court appointed a five-member bench, the Joint Investigation Team, that included members of both the military intelligence and the inter-services intelligence, the State Bank of Pakistan, the Securities and Exchange Commission, and the National Accountability Bureau. An investigation was ordered into the allegations while Sharif continued in office. Despite the court's requests, Sharif's family failed to provide satisfactory documentation on the source of the money they used to buy their London apartments. Some of the documents they produced were also declared fake, as Nawaz's daughter, Mariam, was accused of submitting misleading papers to the apex court. The Joint Investigation Team prepared a report according to which the Sharif family's wealth was far above its members' earnings.¹¹

9. The International Consortium of Investigative Journalists, *The Panama Papers* (<https://panamapapers.icij.org>); Marco Corsi, 'Pakistan 2016: Economic features', pp. 393-394.

10. Articles 62 and 63 of the Constitution of the Republic of Pakistan are available at <http://www.article6263.com/save-pakistan/text-from-the-constitution-article-62-63>.

11. 'Nawaz Sharif, Pakistan's Prime Minister, Is Toppled by Corruption Case', *The New York Times*, 28 July 2017.

On 28 July 2017, the Supreme Court of Pakistan voted unanimously to disqualify Nawaz Sharif from holding public office, including the office of prime minister.¹² It is worth stressing that Sharif was not disqualified because of corruption and money laundering charges. As stated, Sharif was not named in the Panama leaks nor was evidence found that he had abused public office for private gain. The disqualification was rather based on the evidence collected by the Joint Investigation Team, which showed that he had been chairman, on a salary, of the board of a firm based in Dubai – Capital FZE – owned by his son. An income of less than US\$ 3,000 was generated between 2006 and 2014 – which Nawaz said he had never drawn¹³ – but it wasn't declared in Sharif's nomination papers after he won the elections in 2013. The Supreme Court invoked Article 62 of the constitution which refers to the notion of «moral reputation» and the constitutional requirement of a member of parliament to be «honest».¹⁴ It concluded that Mr. Sharif had been «dishonest» for not declaring the income and hiding assets. On these grounds, he could not be deemed fit for office and was disqualified.¹⁵ His case was then referred to the anti-corruption authority – the National Accountability Bureau – for alleged corruption, with the recommendation to investigate the Sharif family's assets.

Anti-corruption charges were recommended also against Sharif's daughter Mariam, her father's political heir who was the owner of the two British Virgin Islands-based firms, and against her husband, Muhammad Safdar, member of the National Assembly. The Finance Minister Ishaq Dar was disqualified from office too, for being unable to explain his ownership of assets beyond his means.¹⁶

This was the third time Nawaz Sharif had served as premier and the third time he didn't reach the end of his mandate.¹⁷ His disqualification

12. Full text of the verdict drafted by the five-member apex court bench is available at the link <https://tribune.com.pk/story/1468750/full-text-supreme-court-verdict-panama-papers-case>.

13. 'PML-N decides Shehbaz to succeed Nawaz as PM', *Pakistan Today*, 30 July 2017.

14. 'What's wrong with the verdict? Everything', *Daily Times*, 29 July 2017.

15. 'The technicality that led to Nawaz Sharif's disqualification', *Dawn*, 28 July 2017; 'How the Panama Papers Changed Pakistani Politics', *The New York Times*, 28 July 2017.

16. 'Nawaz Sharif steps down as PM after SC's disqualification verdict', *Dawn*, 28 July 2017. Former finance minister Ishaq Dar was found to have a 91-times increase in his assets, not matching his known sources of incomes. See 'Nawaz added whopping \$35b to Pakistan's debt', *The Express Tribune*, 30 July 2017.

17. Simonetta Casci, 'La sconfitta di Benazir Bhutto in Pakistan', *Asia Major 1991*; Simonetta Casci, 'I nodi irrisolti della democrazia pakistana', *Asia Major 1994*. Marco Corsi, 'Pakistan: sorprendentemente prevedibile', *Asia Major 1997*; Marco Corsi, 'Il colpo di stato in Pakistan e le sue conseguenze', *Asia Major 2000*; Marco Corsi, 'La grigia politica del governo militare pakistano', *Asia Major 2001*; Marco Corsi, 'Pakistan: il terzo governo di Nawaz Sharif', *Asia Maior 2013*.

came one year before the end of his term. In the country's history, four governments, two led by Prime Minister Benazir Bhutto and two by Nawaz Sharif, were dismissed on charges of corruption and mismanagement.¹⁸ Also, in 2012 the Supreme Court disqualified then Prime Minister Yusuf Raza Gilani over a contempt of court case.¹⁹

The Supreme Court's verdict raised concerns within the PML (N) over judicial interference. In particular, the ruling party felt threatened by the Pakistani military backed by an allegedly subservient judiciary. The Joint Investigation Team's composition reinforced such perception. Over the years, Pakistan's judiciary has undermined any sense of justice by using allegations of corruption against prime ministers while not defending with the same determination the democratic system against military authoritarian interventions and violations committed by armed forces' officials.²⁰ Members of the PML (N) said a precedent had been set in a country where corruption is notoriously high;²¹ more than 400 names of Pakistani citizens appear in the Panama Papers and laws are under-enforced.²² Concerns over the military's involvement in domestic politics were also raised. During his last tenure, Nawaz Sharif had uneasy relations with the generals, in particular in regard to his openness towards India and his approach to fighting militancy,²³ not to mention the long-standing frictions dating back to the 1999 Musharraf coup.²⁴ The army denied any involvement.²⁵ Overall, the disqualification of a sitting prime minister on such a technicality left many analysts, who would have preferred the conclusion of the National Accountability Bureau's investigation before the announcement of the sentence by the apex court, with mixed feelings.

Following Nawaz's disqualification, the National Assembly conferred the mandate to form a new government to Shahid Khaqan Abbasi,²⁶ Minis-

18. Simonetta Casci, 'La sconfitta di Benazir Bhutto in Pakistan'; Simonetta Casci, 'I nodi irrisolti della democrazia pakistana'; Marco Corsi, 'Pakistan: sorprendentemente prevedibile'; Marco Corsi, 'Il colpo di stato in Pakistan e le sue conseguenze'.

19. Marco Corsi, 'Transizione e Nuovi Equilibri', *Asia Maior 2012*, pp. 132-135.

20. 'Pakistan's Court Sets a Dangerous Precedent', *The New York Times*, 28 July 2017.

21. Transparency International ranks Pakistan 116th out of 176 countries in its corruption perceptions index (<https://www.transparency.org>).

22. 'Is Pakistan's Democracy Back to Square One?', *The Diplomat*, 17 August 2017.

23. 'Sharif Disqualification to Worsen Civilian-Military Relations in Pakistan', *The Diplomat*, 28 July 2017; 'Pakistan, Ousting Leader, Dashes Hopes for Fuller Democracy', *The New York Times*, 28 July 2017; Marco Corsi, 'Domestic and Foreign Policy Challenges', *Asia Maior 2015*, p. 453; Marco Corsi, 'Pakistan 2014: Gli attacchi al governo di Sharif e le tensioni con i militari', *Asia Maior 2014*.

24. Marco Corsi, 'Il colpo di stato in Pakistan e le sue conseguenze', pp. 50-58.

25. 'Panamagate saga ends: Prime Minister sent packing', *The Express Tribune*, 28 July 2017.

26. 'Ousted Pakistan Leader Passes Baton to Brother, Shehbaz Sharif', *The New York Times*, 29 July 2017.

ter of Petroleum and Natural Resources, to serve until the next election in mid-2018. Abbasi was elected with 221 votes out of the 342 seats in parliament's lower house, 188 of the PML-N and the rest from allies.²⁷ Abbasi, 58, is the son of a Pakistan Air Force air commodore and son-in-law of a former director general of the Inter-Services Intelligence. Abbasi is an airline owner, PML-N member and Nawaz's loyalist who was jailed after Musharraf's coup in 1999 as he refused to testify against the premier. When Sharif was back in power in 2013, Abbasi was nominated minister.²⁸

After Abbasi's election, the Minister of Finance, Ishaq Dar, who had also been disqualified by the Supreme Court and who ceased to hold the office when the federal cabinet was disbanded, was re-appointed as the minister for finance. However, he had reduced powers, as he was removed from the chairmanship of several committees, including that of Economic Coordination.

3. Economic scenario

In the year under review, Pakistan's economic performance was praised by the international financial organisations and received plaudits from multiple parties. The IMF referred to an overall satisfactory performance and a moment of «opportunity where the country can embark on the next generation of reforms to generate higher and more inclusive growth and tap into the dynamism of emerging economies».²⁹ Similar signs of appreciation came from the World Bank, which applauded the stability of the country's economy.³⁰

The annual budget presented in May 2017, having a total outlay 4.3% higher than estimated in the 2016-17 budget, confirmed the economic growth of Pakistan as 5.3% of the GDP.³¹ It is the highest rate in a decade, although the target set in 2016 (5.7%) was missed. The 2017 budget set the 2018 target at 6%, and 7% by 2020.³²

27. 'Pakistan's Interim Leader Says He's No Bench Warmer', *The New York Times*, 1 August 2017.

28. 'Shahid Khaqan Abbasi: What You Need to Know About Pakistan's New Prime Minister', *The New York Times*, 1 August 2017.

29. The International Monetary Fund, *Pakistan Emerging Markets in the World Economy*, 24 October 2016.

30. 'Pakistan's next economic crisis', *Profit*, 20 February 2017; The World Bank, *Aiming high Pakistan's way forward*, 1 February 2017.

31. This figure was overall confirmed by the projections of the main international financial institutions such as the Asian Development Bank, the World Bank and the International Monetary Fund.

32. Government of Pakistan, Finance Division, *Federal Budget 2017-18. Budget in Brief*, Islamabad 2017 (finance.gov.pk/budget/Federal_Budget_Press_Brief_2017_18.pdf); 'Budget 2017-2018: Is Pakistan really on the upward trajectory?', *The Express Tribune*, 28 May 2017.

The country's sovereign credit is rated at «B» by Standard & Poor's; Pakistan's bonds are rated at «B» by Fitch and «B3» by Moody's.³³ Moody's «B3» rating stands for robust growth performance, fiscal deficit reduction and improved inflation dynamics; in a word, a stable outlook. According to the international rating agency, Pakistan's prospects of growth have increased following the launch of the CPEC (China-Pakistan Economic Corridor) project in 2015. As per Moody's analyses, the performance of Pakistan is also rooted in the successful completion of the latest three-year IMF EFF programme in September 2016³⁴ and economic reforms pursued by the government of Islamabad since 2013 have contributed to increase investors' confidence, macroeconomic stability and higher GDP growth.³⁵

Index provider MSCI (Morgan Stanley Capital International), a research-based provider of index funds, moved Pakistan to «emerging market» from «frontier-market» status. Emerging markets are economically more developed than frontier ones and considered less risky by investors.³⁶ Pakistan joined India, Malaysia and the United Arab Emirates in a group of about 20 countries on the index that represents 10% of world capitalisation.³⁷

When entering office in 2013, Sharif connected his agenda with the wider global transformation's priorities characterised by connectivity, urbanisation, rising middle class consumption and demand for services, security and stability. In 2017, the economic indicators confirmed the reality of the growth of Pakistan's economy. Construction work in Pakistan's largest cities rose dramatically.³⁸ The country was ranked ninth in the «Belt and Road Infrastructure Development Index», as per the International Infrastructure Investment and Construction Forum held by the Macao Trade and Investment Promotion Institute on 2 June 2017.³⁹ Consumer spending

33. Standard & Poor's and Fitch's global rating definitions are available respectively at the links <https://www.standardandpoors.com> and <https://www.fitchratings.com>.

34. Marco Corsi, 'Pakistan 2016: Economic features'.

35. 'Pakistan Shows Strong Growth: Moody's Report', *Pak China News*, 8 May 2017; 'Moody's: Pakistan's B3 rating reflects strengthening growth, progress on structural reforms', *Moody's investor service*, 27 April 2016.

36. 'Pakistan's Status Grows in Indexes', *The Wall Street Journal*, 6 August 2017. According to some estimates, the inclusion of Pakistan in the «emerging market» group of countries would lead to US \$250-275 million flowing into Pakistan's equity market. See 'Despite being a terror hub, Pakistan is the cynosure of investors' eyes. Here's why', *The Economic Times*, 10 March 2017.

37. Details of MSCI's market classification are available at <https://www.msci.com/market-classification>.

38. The All Pakistan Cement Manufacturers Association (APCMA) reports that the production and sale of cement in Pakistan increased rapidly in 2016 and during 2017 (www.apcma.com).

39. 'The 8th International Infrastructure Investment and Construction Forum was successfully concluded. Fruitful Results were Achieved in the Two-day Event', 2 June 2017 (<http://www.ipim.gov.mo>).

in Pakistan has increased by 83% since 2013, compared to 49% overall in the Asia-Pacific region.⁴⁰ In 2016, car sales recorded a 49% increase since 2013, when Sharif took office, with a higher number of vehicles bought in cash. The production of cars, motorcycles, buses, trucks and tractors increased to 6.28%, 21.85%, 4.93%, 40.26%, and 59.65% respectively during the first 11 months of the fiscal year 2016-17 compared to the output of the corresponding period of the previous year.⁴¹ Euromonitor International, an independent provider of strategic market research, proclaimed Pakistan as the fastest growing retail market globally.⁴²

Following the trend of 2016, the reforms undertaken by Pakistan have contributed to rendering the business environment friendlier, as confirmed by the country's inclusion in the global list of top ten most-improved countries in the World Bank's ranking.⁴³ Fuel prices and inflation are lower than in 2016 too,⁴⁴ and significant international companies' acquisitions of Pakistani ones also portray a promising market.⁴⁵

The Karachi Stock Exchange Index, 52%, is higher than the past year, and Pakistan was the best stock market in Asia in 2016.⁴⁶ The Economic Times reported that, in March 2017, six companies listed on the Pakistan Stock Exchange were included by the Financial Times Stock Exchange in its Global Equity Index Asia Pacific series for the first time. According to some estimates, this would result into an inflow of US\$ 56 million.⁴⁷

40. 'Beyond the headlines of terrorism, Pakistan's economy is on the rise', *Washington Post*, 21 February 2017.

41. As per data of the Pakistan Automotive Manufacturers Association (PAMA, www.pama.org.pk). Over 200,000 cars were sold in fiscal year 2016, the highest volume ever, and the largest Pakistani car makers (Suzuki, Honda, Kia Motors, Hyundai) are expanding their capacities. See 'Despite being a terror hub, Pakistan is the cynosure of investors' eyes. Here's why'. From May 2016 to May 2017, the production of cars and jeeps grew by 19.35%, according to latest data of the Pakistan Bureau of Statistics. See 'Car production goes up by 6.28pc during eleven months of FY 2016-17', *Profit*, 20 July 2017; 'Pak Suzuki reports 39pc YoY increase in net profits', *Profit*, 26 July 2017.

42. <http://www.euromonitor.com>; 'Pakistan is the world's fastest growing retail market, says: Euromonitor', *Profit*, 29 September 2017.

43. The World Bank, *Doing Business Survey 2017*, Washington, 2016; 'Europe's leading HTV manufacturer SCANIA enters Pakistan', *Profit*, 7 June 2017; 'Volkswagen to enter Pakistan's automobile sector', *China-Pakistan Economic Corridor*, 16 February 2017; 'World's top carmakers to assemble brands for Pakistani customers', *Pakistan & Gulf Economist*, 28 August 2017.

44. 'Despite being a terror hub Pakistan is the cynosure of investors' eyes. Here's why'.

45. As in the recent acquisition of Engro Foods by the Dutch dairy company, FrieslandCampina (<https://www.frieslandcampina.com>).

46. 'Beyond the headlines of terrorism, Pakistan's economy is on the rise', *The Washington Post*, 21 February 2017.

47. 'Despite being a terror hub, Pakistan is the cynosure of investors' eyes. Here's why'.

4. Economic vulnerabilities and challenges

The IMF warned that stability gains made under the last EFF program had begun to erode and macroeconomic vulnerabilities have re-emerged in 2017.⁴⁸

Public debt in Pakistan is a well-known issue.⁴⁹ Moody's «very low» rating of Pakistan's fiscal strength reflects the debt burden. The country has incurred debts with both domestic sources, such as commercial banks, and external sources, such as the IMF or foreign banks. In FY 2017 70% of the total public debt was from domestic sources (a steep increase from FY 2000, when it was a little less than half). Debt from domestic sources, although does not involve the stern conditions imposed by international financial institutions, is more expensive. According to the latest available data, in 2014 interest rate on domestic loan was 11.3% while interest rate on external debt was only 2.1%.⁵⁰ External debt (having an interest rate of 2.1% in 2014) accounts for about 30% of the total.⁵¹ While inflows from multilateral institutions declined in the year under review, the government borrowed substantially from commercial banks. According to data from the IMF, Pakistan's public and publicly guaranteed debt increased to 70% of GDP in fiscal year 2015-16, while public debt excluding guarantees rose to about 67.5% of GDP. From July 2013 to June 2017, during Sharif's government, Pakistan's total external debt grew by 30%, from US\$ 60.9 billion to US\$ 79.2 billion.⁵²

Between 2013 and 2017, the PML-N government received US\$ 35 billion in new loans, adding US\$ 18 billion to external debt.⁵³ New loans worth US\$ 10 billion – the highest amount ever borrowed in a single year in the country's history – were taken out in the last year of Nawaz's tenure, 2016-2017. In the same period, external public debt also increased to 28%, jumping from US \$49 to US \$62.3 billion. In addition, gross external financing requirements almost doubled, escalating from US\$ 9.1 billion to US\$ 17.2 billion.⁵⁴

48. 'Pakistan: 2017 Article IV Consultation'. In December 2017, the first International Monetary Fund monitoring mission, since the end of Pakistan's EFF in September 2016, confirmed that while economic growth has been accelerating and inflation remains subdued, Pakistan is facing important near-term economic challenges: in particular, surging imports have led to a decline in international reserves despite higher external financing. See International Monetary Fund, *IMF Staff Completes Mission for the First Post-Program Monitoring to Pakistan*, 14 December 2017.

49. Marco Corsi, 'Pakistan 2016: Economic features'.

50. 'What's wrong with public debt in Pakistan', *Profit*, 12 June 2017.

51. Asian Development Bank, *Basic 2016 Statistics*; State Bank of Pakistan, 'Pakistan's External Debt and Liabilities - Outstanding' (<http://www.sbp.org.pk>).

52. 'Pakistan: 2017 Article IV Consultation'.

53. 'Nawaz added whopping \$35b to Pakistan's debt'.

54. 'Pakistan: 2017 Article IV Consultation'.

Pakistan's high current account deficit in fiscal year 2017 reached US\$ 12.1 billion, a 149% increase since the end of the previous fiscal year. Imports increased by 14.2% compared with the same period in fiscal year 2016 while exports declined by 1.2%, which continues a trend that began in 2015.⁵⁵ The IMF shows that the total gross external debt as a percentage of exports increased from 193.2% in 2013 to 294.4% as of June 2017, marking a decline of exports and fast rising imports of capital goods and energy.⁵⁶

Pakistan's foreign currency reserves are built upon exports and foreign borrowing. As result of borrowing, in the period 2013-2016 the gross official reserves held by the State Bank of Pakistan increased from US\$ 6 to US\$ 18 billion but they receded to US\$ 13.8 billion by the end of October 2017 (EFF ended in September 2016) and remain below comfortable levels.⁵⁷ As of August 2017, the reserves were reduced to less than three months of import bills, which is the eligibility threshold to receive financial assistance from one of the two main arms of the World Bank, namely the International Bank for Reconstruction and Development.⁵⁸

In the year under review, fiscal consolidation slowed down and mobilisation of tax revenue wasn't as strong as considered necessary by the international financial institution.⁵⁹ The fiscal deficit for the first half of fiscal year 2017 stood at 2.4% of GDP, 0.6% higher than the same period last year.⁶⁰

Finally, from fiscal year 2016 to fiscal year 2017, Pakistan's FDI slightly increased from US\$ 2.3 billion to US\$ 2.41 billion, merely reflecting growing Chinese investor confidence.⁶¹ Doubts arose in the year under review as to whether the CPEC and foreign investment from China would be enough to allow a recovery of the economy.

5. The CPEC

With planned investments, the equivalent of almost 20% of the country's total GDP,⁶² the CPEC promises to be an unprecedented development

55. 'Pakistan Economy In Crisis: Enormous CAD in Financial Year 2017', *Value Walk*, 22 July 2017; 'Pakistan Development Update'.

56. *Ibid.* In the first seven months of fiscal year 2017 exports declined by 1.3% to US\$ 12.3 billion and imports increased by 9% to US\$ 25.5 billion. 'Pakistan will be paying China \$90b against CPEC-related projects', *The Express Tribune*, 12 March 2017. 'Foreign Exchange Reserves'.

57. State Bank of Pakistan, *Foreign Exchange Reserves*.

58. 'Pakistan May Soon Be Ineligible For World Bank Loans', *Pak-China News*, 15 August 2017.

59. 'Tax revenues were at 0.6% of GDP in 2016-17; Pakistan: 2017 Article IV Consultation'.

60. Marco Corsi, 'Pakistan 2016: Economic features', pp. 390-391.

61. 'Pakistan: 2017 Article IV Consultation'.

62. 'Despite being a terror hub Pakistan is the cynosure of investors' eyes. Here's why'.

opportunity for Pakistan.⁶³ However, the CPEC is not a multi-billion US\$-worth donation from China to the Pakistani economy. On the contrary, it entails loans from Chinese banks, to be paid back by the Pakistan government, companies, and taxpayers-at-large. According to estimates, Pakistan will pay US\$ 90 billion to China over a period of 30 years against US\$ 50 billion loan and investments under the CPEC, with a 40% return on investment sum of principal, and interest on foreign currency debt and repayment of profits/dividend on equity investment.⁶⁴ Free and low interest loans to Pakistan will be pursued, yet Pakistan's federal and local governments would be expected to co-fund the CPEC.

In May 2017, the daily «Dawn» unveiled a report of the China Development Bank and the Chinese National Development Reform Commission presenting the detailed objectives of the CPEC, and Chinese intentions and priorities in Pakistan for the next 15 years.⁶⁵ The CPEC is primarily aimed at boosting the Chinese economy; hence the use of Chinese materials and equipment and the creation of job opportunities for Chinese manpower are its main objectives. The plan envisages a penetration of multiple sectors of Pakistan's economy and society by Chinese enterprises and culture. It calls for building infrastructures and a supporting policy environment to facilitate entry of Chinese investors; it entails industrial and transport undertakings, connectivity, and large agricultural projects and plans. The disclosed plan refers also to law and order-related projects, expected to be launched in Pakistan, while tourism and recreation sectors will be assertively promoted. From the cultural perspective, CPEC aims to spread Chinese culture and language in Pakistan to «further enhancing mutual understanding between the two peoples and the traditional friendship between the two countries».⁶⁶

Relying on assessments of the IMF, the World Bank and the Asian Development Bank, the report recommends a maximum annual Chinese direct investment in Pakistan of roughly US\$ 1 billion as Pakistan's economy could not absorb more than US\$ 2 billion FDI per year without being subject to excessive stress.⁶⁷ The report advises Chinese enterprises to protect their own investments by conducting business with Pakistan with the support of the government, the banks as intermediary agents and enterprises as the mainstay. One of the risks the plan refers to is linked to the weakness in Pakistan's ability to earn foreign exchange. The reports states also that the financial and monetary cooperation with Pakistan serves China's diplomatic strategy.

63. Marco Corsi, 'Pakistan 2016: Economic features', pp. 396-398.

64. 'Pakistan will be paying China \$90b against CPEC-related projects', *The Express Tribune*, 12 March 2017.

65. 'Exclusive: CPEC master plan revealed', *Dawn*, 21 June 2017.

66. *Ibid.* (Fibreoptics and surveillance).

67. *Ibid.* (Finance and risk).

The report – labelled as «incorrect»⁶⁸ by the Government of Pakistan for not reflecting the actual discussions between Pakistan and China – portrays a potentially alarming scenario, as it stresses only Chinese interests. As of the end of 2017, none of Pakistan's long-term goals and expected gains from the economic enterprise with China have been clearly outlined by Islamabad. This lack of information triggered comments from Pakistani scholars portraying scenarios according to which the CPEC might end up bringing rich dividends to China only.⁶⁹ CPEC's critics warn about the possible transformation of the Pakistani economy which would come at the price of accepting Chinese economic influence, with possible implications on Pakistan's foreign policy and political repercussions.⁷⁰ In a sense, these warnings find confirmation in a UNESCAP (United Nations Economic and Social Commission for Asia and Pacific) recent study according to which the CPEC may exacerbate tensions with India while Afghan instability may hamper the actual benefits of transit corridors in South Asia.⁷¹ Similar admonitions come from the IMF, according to which the massive financial inflow associated with the early CPEC investments might be offset by the surge in imports required for the projects and result in a widening account deficit.⁷² Recently, the World Bank expressed similar concerns about the increased fiscal risks over the medium term linked to the CPEC.⁷³ Prominent Pakistani economists have also expressed doubts over Pakistan's capacity to service the debt attached to the Chinese investments and have advised it to adopt appropriate safeguard measures.⁷⁴

68. 'Understanding China's 'Master Plan' for Pakistan. Which country stands to gain the most from the China-Pakistan Economic Corridor?', *The Diplomat*, 18 May 2017.

69. 'Can Pakistan Afford CPEC?' *The Diplomat*, 16 June 2017.

70. 'After OBOR gets ready, Pakistan will become China's colony: S Akbar Zaidi', *The Economic Times*, 12 June 2017; 'For Pakistan, China's huge energy investments may have serious political costs', *The Conversation*, 14 July 2017.

71. UNESCAP, *The Belt and Road Initiative and the Role of ESCAP*, Bangkok, May 2017 (the report is not available online and information on the contents can be seen at the link <http://www.news.civilserviceindia.com/cpec-may-create-more-india-pakistan-tension-un-report>).

72. The International Monetary Fund, *Twelfth and final review under the extended arrangement, request for waivers of no observance of performance criteria, and proposal for post-program monitoring- press release; staff report; and statement by the executive director for Pakistan*, 13 October 2016.

73. The World Bank, *Global Economic Prospects, A Fragile Recovery*, Washington, June 2017.

74. 'CPEC cost build-up', *Dawn*, 15 December 2016; 'CPEC: A Game Changer Or Debt Enhancer For Pakistan? - Analysis', *Eurasia Review*, 5 February 2017.

6. Pakistan and the Shanghai Cooperation Organisation

After the process had begun in 2015, Pakistan and India's membership in the SCO (Shanghai Cooperation Organisation) was formalised during the Organisation's June 2017 summit held in Kazakhstan's capital city, Astana. SCO is a permanent intergovernmental international organisation and a significant forum aimed at strengthening mutual trust, promoting cooperation, and ensuring peace, security and stability among the member states and in the region.⁷⁵ The now eight-member group embraces countries having notable reserves of natural resources and includes four of the world's nuclear powers. The SCO group counts also nearly half of the global population and its member states account for about one quarter of global gross domestic product.⁷⁶

Pakistan has been enjoying cordial relations with the SCO member states and has multiple reasons for being interested in joining the alliance. Islamabad is already cooperating with Tajikistan and Kyrgyzstan on the CASA-1000 (Central Asia - South Asia) Project, aimed at exporting surplus electricity from the two Central Asian countries to Pakistan and Afghanistan. Moreover, through QTTA (Quadilateral Traffic in Transit Agreement), a transit trade deal involving China, Pakistan, Kyrgyzstan and Kazakhstan, Islamabad has been working towards facilitating the transportation of goods from Central Asia to South Asia. SCO provides Pakistan with greater access to oil, gas, and other trade opportunities, while Pakistan provides access to the Arab Sea to SCO countries. In addition to that, SCO has endorsed and supported the CPEC, which provides Pakistan access to Tajikistan via China, thus bypassing Afghanistan.

Equally important strategic and security-related aspects connect Pakistan to SCO. The organisation keeps the security agenda on top of its priorities, that is, member states' mutual confidence building and countering the menace of terrorism. SCO's security approach entails military, institutional and intelligence cooperation. Pakistan benefits from the specific anti-terrorism expertise developed by SCO member states and expands its defence capacities with the SCO alliance.⁷⁷

75. In 1996 the «Shanghai Five» organisation was founded comprising China, Kazakhstan, Kyrgyzstan, Russia and Tajikistan. Uzbekistan joined the group in 2001 and the organisation was then renamed the «Shanghai Cooperation Organisation». Up to June 2017, Pakistan was one of the six SCO observer states (along with Afghanistan, Belarus, India, Iran and Mongolia). More information available at the SCO's website <http://eng.sectsc.org>.

76. 'Game changer: India, Pakistan & Iran Joining BRICS Shanghai Cooperation Organization', *Geopolitics*, 23 April 2017.

77. Saif ur Rehman Muhammad, 'Significance of Shanghai Cooperation Organization – Pakistan's perspective', *Margalla Papers*, Vol. XVIII, Issue 1, National Defense University, Islamabad 2014, (<http://www.ndu.edu.pk>).

7. *Pakistan-Afghanistan relations*

Operation Zarb-e-Azb, launched in June 2014,⁷⁸ successfully focused on eradicating militancy from the north-western regions of Khyber Pakhtunkhwa and the FATA (Federally Administered Tribal Areas).⁷⁹ Violence erupted again in Pakistan in February 2017. From 13 to 17 February 2017, the country was hit by a series of attacks which killed 125 people and injured several hundred more. On Monday 13 February 2017, a suicide bomber detonated himself in central Lahore, the provincial capital of Punjab, during a rally. The attack was claimed by the JuA (Jamaat-ul-Ahrar), a splinter group of wider umbrella organisations from Pakistan's TTP (Tehreek-e-Taliban). Two days later, a wave of suicide attacks occurred in Mohmand Agency in FATA and in Peshawar, the provincial capital of Khyber Pakhtunkhwa. On 16 February 2017, approximately 90 people died and more than 250 were wounded by an attack of the Islamic State at the Sufi shrine of Lal Shahbaz Qalandar, in the Sindh province.

On 22 February 2017, the Pakistan Armed Forces announced the launch of a new operation against terrorists across the country called Radd-ul-Fasaad («Elimination of Discord».⁸⁰ It is a nationwide operation which entails coordinated efforts of Pakistan's Air Force, Navy, and civilian armed forces and is aimed at «indiscriminately eliminating the residual/latent threat of terrorism», consolidating the gains made in other military operations.⁸¹ Khyber-IV is part of Operation Radd-ul-Fasaad which focuses on the Khyber Agency. Separately, in Punjab, Rangers, the Counter Terrorism Department, and the Police conducted operations against terrorist outfits and their facilitators.⁸²

78. The National Action Plan prepared after the massacre of more than 130 schoolboys by the TTP in Khyber Pakhtunkhwa in 2014 (Marco Corsi, 'Domestic and Foreign Policy Challenges') has not been fully implemented. Regulation and reform of madrassas, religious schools that foster militancy, has been half-hearted. See 'Role reversal. Pakistan blames Afghanistan for a spate of terrorist attacks', *The Economist*, 23 February 2017.

79. A substantial drop in terrorist activity was recorded in 2015 with 45% fewer attacks and 38% fewer deaths than in the previous year. See 'Global Terrorism Index 2017', *Institute for Economics and Peace*, <http://economicsandpeace.org>; Marco Corsi, 'Pakistan 2016: Economic Features'. The annual Country Reports on Terrorism released on 19 July 2017 by the US State Department confirms that the number of civilian deaths in Pakistan caused by terrorism fell to 600 in 2016, from 3,000 in 2013. According to the same report, Pakistan had the fourth-highest number of terrorist attacks worldwide in 2016. See US Department of State, Bureau of Counterterrorism and Countering Violent Extremism, *Country Reports on Terrorism 2016*, (<https://www.state.gov/documents/organization/272488.pdf>).

80. 'Pakistan's new war on terror', *Indian Express*, 1 March 2017.

81. 'De-weaponisation-part-operation-radd-ul-fasaad', *The Express Tribune*, 1 March 2017.

82. 'Operation Khyber-IV: 110 square km area cleared, number of terror hideouts dismantled', *The Express Tribune*, 28 July 2017.

Multiple attacks conducted on Pakistani soil have involved Afghan perpetrators, which contributed to increased tension between the two countries. The Durand line, the porous Afghan-Pakistan border, is not granted official demarcation status by the government of Kabul, and border clashes between the two countries have erupted frequently since the independence of Pakistan in 1947. Both governments have exchanged accusations of state support to infiltrating militants: Islamabad accuses Kabul of providing safe havens to the TTP and the JuA, while Afghanistan accuses Pakistan of harbouring the Afghan Taliban and the Haqqani network, an Afghan insurgent group.⁸³ In 2017, the Pakistani military intensified the hunt for militants with airstrikes and ground operations in the north-western areas, requesting the support of the government of Afghanistan while accusing Kabul of providing shelter to armed groups.⁸⁴ In April-May 2017, the Pakistan army's cross-border shelling targeted the Nangarhar province, in Afghanistan, considered the headquarters of militant outfits. Attacks on Pakistan army check posts occurred also in Mohmand Agency in Pakistan's FATA. A ceasefire was then announced on 5 May 2017. The Pakistan-Afghanistan western border, at the Torkham and Chaman crossings, was sealed and reopened multiple times in 2017. As per directions of Chief of Army Staff Qamar Javed Bajwa, in June 2017 Pakistan started fencing its entire border with Afghanistan to both regulate people's movement and reduce the infiltration of terrorists.⁸⁵

The impact on diplomatic relations was notable, with the Afghan president, Ashraf Ghani, refusing to visit Pakistan in May 2017 following a formal invitation, and citing the support provided by Pakistani military to the Taliban insurgency.

8. Pakistan - USA relations

In June 2017, in its six-month report to Congress, the Pentagon stated that Pakistan is the most influential external actor affecting Afghan stability and the military alliance's mission. Reference was explicitly made to militant groups active in Afghanistan and retaining freedom of action in Pakistan.⁸⁶ Besides seeking more powers for the military, the Pentagon also advised Washington to use its relations with both Pakistan and Afghanistan to improve the ties between the two neighbouring countries. The report

83. 'Afghanistan, Pakistan, and the Good Taliban', *The Diplomat*, 10 March 2017.

84. *Ibid.*

85. 'Border management: Pakistan starts fencing Afghan border to curb infiltration', *The Express Tribune*, 20 June 2017.

86. U.S. Department of Defence, *Enhancing Security and Stability in Afghanistan*, June 2017 (https://www.defense.gov/Portals/1/Documents/pubs/June_2017_1225_Report_to_Congress.pdf).

highlighted that the trust deficit resulting from Pakistan's inaction against Afghan-oriented extremists had hampered the bilateral military collaboration required to achieve enduring security.

In the press conference following the talks about the future of the NATO-led «Resolute Support Mission» in Afghanistan, NATO Secretary General Jens Stoltenberg, answering a question on terrorists' sanctuaries in Pakistan, stated that «it is absolutely unacceptable that a country provides sanctuary to terrorist groups which are responsible for terrorist attacks inside another country and the only way to achieve lasting peace is to have a regional approach».⁸⁷

Senator John McCain, chairman of the US Senate Armed Services Committee, visited Islamabad and Kabul in July 2017 after the United States' and NATO's decision to increase troop numbers in Afghanistan as a reaction to the resilient Taliban-led insurgency.⁸⁸ In Islamabad, McCain reiterated that the United States expects Pakistan's cooperation against terrorist organisations and warned it to stop supporting militant outfits or Washington could change its attitude towards a country once considered a close ally.⁸⁹

The US strategy for Afghanistan was then unveiled by Senator John McCain on 10 August 2017 as a filed amendment to the next fiscal year's defence bill (National Defense Authorization Act for Fiscal Year 2018).⁹⁰ Later, on 21 August 2017, it was formally presented by US President Donald Trump.⁹¹ The strategy entails additional troops being sent to Afghanistan and more powers to the military while leveraging Washington's relations with both Pakistan and Afghanistan to improve ties between the two South Asian countries.⁹² It also appreciates the key role that has to be played by Pakistan as the most influential external actor affecting both Afghan stability and the outcome of the US and NATO missions, and emphasises the need to establish regional dialogue and cooperation to promote Afghan political reconciliation. According to this policy, long-term stabilisation of Afghani-

87. 'Press conference by NATO Secretary General Jens Stoltenberg following the meeting of the North Atlantic Council with Resolute Support operational partner nations at the level of Defence Ministers', 9 November 2017 (<http://nato.int>).

88. 'McCain calls for support of Pakistan to eliminate militancy in Afghanistan', *Dawn*, 5 July 2017.

89. 'McCain's warning reflects changing mood in Washington towards Pakistan', *Dawn*, 6 July 2017.

90. 'McCain Calls for New Strategy for Afghanistan', 10 August 2017, (<https://www.mccain.senate.gov>).

91. 'Trump Outlines New Afghanistan War Strategy With Few Details', *The New York Times*, 21 August 2017; 'Trump's Afghanistan Plan: Old Wine in a New Bottle', *The Diplomat*, 23 August 2017.

92. 'US Centcom chief stresses sustained ties with Pakistan', *Dawn*, 20 August 2017; 'Trump backs off Afghan withdrawal, lambasts Pakistan over terrorist safe havens', *Dawn*, 22 August 2017.

stan will be achieved through integration into regional patterns of political, security, and economic cooperation. In this sense, the new US Afghan policy confirmed the approach of the US and NATO-led operation Resolute Support Mission, which focuses on strengthening ties between Afghanistan and Pakistan.⁹³

As part of a hardened approach towards Pakistan, the US plan reiterates that the USA will no longer tolerate Pakistan's safe havens and that pressure will be put on Islamabad to crack down on the militant sanctuaries located on the border with Afghanistan. The plan threatens Pakistan with graduated diplomatic, military, and economic costs if it continues to provide the alleged support to insurgent groups.⁹⁴

From 2002 to 2016, the United States disbursed more than US\$ 33 billion in aid to Pakistan.⁹⁵ In July 2017, Washington announced the withholding of US\$ 50 million in military reimbursements to Pakistan due to Islamabad's inaction and ineffectiveness in taking decisive action against militant groups based in Pakistan that are a threat to the region.⁹⁶ A week after the presentation of the strategy, the Trump administration notified the US Congress that it was allocating US\$ 255 million (a portion of the US\$ 1.1 billion foreign military financing authorised by congress in 2016) in military assistance to Pakistan. The foreign military financing provides grants and loans to purchase US defence equipment and for acquiring services and military training in the United States.⁹⁷ However, Islamabad can only access the funds if it cooperates more in cracking down on the internal anti-governmental networks.⁹⁸

In October 2017, US Secretary of State Rex Tillerson visited Islamabad and, in line with the strategic approach chosen by the Trump administration, warned Pakistan once again to stop supporting terrorist groups.⁹⁹

93. 'Sharif's Resignation Comes as U.S. Debates How to Pressure Pakistan on Terrorism', *The New York Times*, 28 July 2017.

94. Specific sanctions and legal threats with which Pakistan could be targeted were not initially disclosed. See 'US to withhold \$50m of coalition support fund to Pakistan', *Profit*, 22 July 2017; 'New Afghan strategy threatens graduated sanctions on Pakistan', *Dawn*, 12 August 2017; 'McCain releases strategy for Afghanistan, preempting and rebuking Trump', *The Washington Post*, 11 August 2017.

95. Marco Corsi, 'Pakistan 2016: Economic features', p. 399.

96. 'US to withhold \$50m of coalition support fund to Pakistan', *Profit*, 22 July 2017. The Coalition Support Fund supports the costs above the regular military costs, incurred by Pakistan in fighting terrorism; 'U.S. Gives Military Assistance to Pakistan, With Strings Attached', *The New York Times*, 30 August 2017.

97. 'US attaches new conditions to pledged military aid', *Dawn*, 1 September 2017.

98. *Ibid.*

99. 'U.S. Warning to Pakistan: Stop Backing Terrorism', *The New York Times*, 24 October 2017.