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ISBN: 978-1-4422-2535-0 (pb); 978-1-4422-2536-7 (eBook)
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The project from which this report derives was funded in part by a grant from The Ploughshares Fund to study opportunities for cooperation between the United States and Pakistan. The author is grateful for the long support Ploughshares has offered to the Program on Crisis, Conflict, and Cooperation (C3) at CSIS and is especially grateful to Kelly Bronk for her continued support.

The author would like to thank Kathryn Mixon for research and editing support. Similarly, C3 interns Cristina Sima, Andrew Halterman, Julie Halterman, Max Wilson, and Elias Harpst provided critical research support.
This report discusses current relations between the United States and Pakistan, the historical context of this relationship, and potential avenues for increased cooperation between the United States and Pakistan moving forward. The findings presented in this report are based on individual interviews and roundtables, conducted in Pakistan and the United States with more than 220 people, including policymakers, development experts, bureaucrats, political party representatives, foreign policy experts, journalists, military personnel, civil society representatives, and U.S. government officials.

The relationship between the United States and Pakistan has been redefined repeatedly since Pakistan’s independence in 1947. Today, the research for this report suggests, there is a growing recognition in both countries that the relationship is one of mutual necessity: “transactional” rather than “strategic.” Despite obstacles, this recognition provides an opportunity for constructive cooperation.

Tensions between the two countries are likely to continue beyond the impending U.S. withdrawal from Afghanistan. These will revolve around several issues, including mutual distrust, internal threats to Pakistan’s stability, relations with Afghanistan, the viability of engaging the Taliban in peace talks, and the U.S. role in Afghanistan beyond 2014.

Recent circumstances, however, have also given rise to potential opportunities for improved relations. The United States has already increased civilian assistance to Pakistan, for example, with the Kerry-Lugar-Berman Act, and continued civilian aid could help improve the relationship. Pakistan’s energy crisis offers an important venue through which the United States can provide tangible support. The first peaceful transition from one elected government to another gives the United States positive reason for continuing to support its civilian institutions. Despite occasional setbacks involving traditional sources of tension, such as the line of control over Kashmir, Pakistan has shown a growing willingness to improve relations with India over the past few years. Pakistan’s young demographic favor economic growth, but this could be a risk if Pakistan fails to offer real employment opportunities. The most promising aspect of the U.S.-Pakistan relationship, therefore, is the continuing increase in trade and economic cooperation between the two countries.

The United States could take several steps to foster a more cooperative relationship with Pakistan, mainly by supporting economic growth. It should work with local and
international businesses to better target U.S. aid programs to support private-sector activity; share U.S. embassy expertise with companies and investors to help them better identify opportunities and risks; and support infrastructure projects needed for particular economic sectors to grow. The United States should continue to increase bilateral trade with Pakistan as well, including the pursuit of treaty arrangements. Finally, it should focus more of its civilian assistance in Pakistan on creating jobs and opportunities for young people.
On November 26, 2011, near the disputed border area of Salala between Afghanistan and Pakistan, shots rang out in the dark of night. North Atlantic Treaty Organization (NATO) soldiers in Afghanistan and Pakistani soldiers stationed at checkpoints on the Pakistani side of the border engaged in a fire fight that left 24 Pakistani soldiers dead. Afghan and U.S. officials claimed that the NATO soldiers were fired upon first. Pakistani officials said the incident was “unprovoked without reason” and an attack on Pakistan’s sovereignty.1 Pakistan’s government almost immediately closed down all NATO supply routes through Pakistan, complicating the transport of supplies and equipment to Afghanistan.

The “Salala incident” was a defining moment in an already challenged relationship, not because it transformed the relationship but because it created an opportunity to reset it, giving both countries time to assess the relative importance they placed on the relationship. With the supply routes—or “ground lines of communication”—shut down, the United States was forced to ship supplies into Afghanistan through its northern routes at an additional cost of approximately $100 million per month.2 After seven months Pakistan agreed to reopen the supply lines in exchange for the same $250 per vehicle it had been charging plus an additional charge of $1.2 billion to cover costs of Pakistani troops operating along the Afghan border.3 This incident helped both governments realize the need to cooperate.

A year later I traveled to Pakistan for two months to take stock of the relationship between the United States and Pakistan and to see how Pakistanis’ attitudes toward their most critical challenges have evolved. I hosted four roundtables and conducted scores of individual interviews in Islamabad, Lahore, and Karachi, plus two roundtables and additional interviews in Washington. In all I canvassed the views of more than 220 people, including policymakers, development experts, bureaucrats, political party representatives, foreign policy experts, journalists, military personnel, and U.S. government officials stationed in Pakistan as well as Washington. I was particularly interested in finding

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opportunities for cooperation between the United States and Pakistan. The findings are summarized in this report. Chapter 2 offers background information on U.S.-Pakistan cooperation historically. Chapter 3 discusses the findings of the research, including continuing points of contention, possible areas of cooperation, issues related to Afghanistan, and possibilities for trade and economic ties. The final chapter makes recommendations for improving cooperation in ways that might address some of Pakistan’s most serious problems and the United States’ most serious concerns.
Despite earlier rhetoric about the importance of a “strategic” relationship between the United States and Pakistan, officials in both countries today generally admit that the relationship has been primarily “transactional.” For a time after the 2011 Salala incident (discussed in the introductory chapter), policymakers scrambled to make it look strategic. Today, however, there is broad acceptance that the relationship is going to remain transactional for the foreseeable future. In the words of a former Pakistani ambassador to the United States, “when it comes to the U.S.-Pakistan relationship, the word ‘strategic’ is a much-prostituted word.”1 Or as a former Pakistani ambassador to India wryly put it, “if you transact enough, the relationship apparently becomes strategic.”2 Expectations have been lowered on both sides while both have realized the ways in which each needs the other. For the United States, a viable exit from Afghanistan would be prohibitively expensive if Pakistan continued to deny access.3 In Pakistan, policymakers were forced to question where a withdrawal from Afghanistan would leave them and what the ramifications would be for Pakistan’s internal stability.

These realizations has tempered the relationship and opened up opportunities for a new way forward. Today officials in both capitals are more willing to admit that cooperation between the two countries is essential if one of their most important shared objectives is to be achieved: a peaceful settlement to the conflicts in Afghanistan. The challenge until U.S. forces are largely withdrawn in 2014, of course, is that both countries (among others, including Afghanistan) remain at odds over how to achieve this objective. Certainly Pakistan does not want an increase in Indian influence in Afghanistan or an Afghan government hostile toward Pakistan. Yet even on the question of Afghanistan’s future, Pakistani officials have begun talking about it less in terms of “strategic depth”—a doctrine designed to give Pakistan a territorial hedge in case India attacked—and more in terms of constructive engagement, though of course concerns about India have not entirely disappeared.

Pakistan’s severe internal challenges have certainly played a role in its leaders’ reevaluation of their position. The threat from violent extremists within Pakistan has led that country’s policy makers in government and the armed forces to admit on a number of

2. Aziz Khan, former Pakistan ambassador to India, author interview, Islamabad, January 2013.
occasions that India is no longer its biggest threat. Additionally, the large energy crisis has only compounded the dismal economic conditions reflected in high unemployment and inflation, bad macroeconomic fundamentals, low foreign direct investment (FDI), and huge outflows of capital. Given the internal challenges, antagonistic foreign policies that damage other countries’ interests in the region can only be harmful for future growth and progress within Pakistan.

It would appear that, at least through 2014 and probably beyond, the relationship for both countries is one of necessity. The United States needs Pakistan’s cooperation and assistance because Pakistan’s supply lines are critical for a smooth withdrawal from Afghanistan. More generally, a cooperative Pakistan will be vital for any successful political settlement in Afghanistan that is feasible and lasting. The presence of nuclear weapons and extremist groups in Pakistan means that the United States needs at least enough engagement to facilitate the exchange and collection of intelligence.

For its part, Pakistan needs the United States and the North Atlantic Treaty Organization (NATO) to minimize the risk that Afghanistan’s conflict could deteriorate. Spillover and contagion would exacerbate Pakistan’s own internal security challenges. There are also economic motivations to work with the United States. For example, 18 percent of total remittances to Pakistan came from the United States in 2011. On average, 20 percent of exports since 2003 have gone to the United States. In 2011, although FDI in Pakistan was low in absolute terms, 35 percent of that FDI came from the United States. The United States has played a key role in commodity products that Pakistan sells. Commodity prices have been very volatile and this volatility is likely to continue until 2014. Pakistan needs a stable trading partner such as the United States, especially when there are price shocks for commodities. There are two main ways that commodity price fluctuations exacerbate poverty and development in countries such as Pakistan. Pakistan has many who live on less than $2 a day, which makes the population vulnerable to abrupt price shocks for staple commodities such as food and fuel. Increased prices for staple commodity goods intensifies the situation of the already poor, pushes up the number of absolute poor, and makes more Pakistanis vulnerable to poverty. Price fluctuations will also force action from the Pakistani government to alleviate the situation, which will drive up government debt and displace other government spending. Pakistan’s economy is also exposed to market volatility and international price shocks because exports are driven by only a few commodities, such as cotton. Volatility in export earnings has adverse effects on “growth, employment, investment planning, export capacity, foreign exchange reserves, inflation, capital flight and debt payments.”

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6. Ibid.
8. Ibid.
Pakistan also needs continued support from the International Finance Institutions (IFIs) in which the United States plays a large role. For example, Pakistan needs liquidity to pay off loans that are coming due and to address its balance of payment (BoP) issues. The two main sources for addressing the BoP issues are organizations over which the U.S. has significant influence: the International Monetary Fund (IMF) and the World Bank.9

Most of the stakeholders interviewed for this project said they believed the United States would remain engaged with Pakistan because of concerns over extremist groups, nuclear weapons, and the withdrawal from Afghanistan. There were differing views as to the extent and scope of future cooperation. The remainder of this report spells out the various arguments, perceptions, and beliefs encountered during the research and identifies potential areas for new or expanded cooperation.

Diplomatic Relations before 2001

Pakistan and the United States have had a tumultuous and varied relationship since Pakistan's independence in 1947. The United States viewed Pakistan as an ally during the Cold War and as a key player against Soviet expansionism. Pakistan welcomed Washington's assistance, which assuaged Pakistani fears about India's power in the region.

U.S. military support for Pakistan began in 1954 with the signing of a mutual defense pact and the formation of the Baghdad Pact in 1955 (later the Central Treaty Organization, or CENTO), which was modeled after NATO and initially included Turkey, Iraq, Great Britain, Pakistan, and Iran.10 The mutual defense organization was intended to contain the Soviet Union along its southern border and insulate the Middle East from Communist expansion.11 In 1955 Pakistan joined the South-East Asia Treaty Organization (SEATO), the counterpart to CENTO. From 1955 onward, except for the 1965–1975 embargo in response to the Indo-Pakistani wars, the United States provided military assistance to Pakistan and trained many Pakistani soldiers in the United States.12 American officers visited Pakistan for training and to make presentations on strategy and military subjects.

Civilian aid to Pakistan peaked in the early 1960s, as the U.S. Agency for International Development (USAID) provided demand-driven assistance. Local civil society groups and the provincial governments proposed projects, and USAID gave matching grants. Between 1953 and 1961, Pakistan received almost $2 billion in assistance, but almost a quarter of

that went to the military. These civilian aid programs were considered to be largely successful.\(^\text{13}\)

The regional wars of the 1960s involving India, Pakistan, and Bangladesh changed U.S. strategic interests in the region and weakened the U.S.-Pakistan relationship. In response to the wars, the United States cut off assistance to Pakistan (with the exception of food aid) intermittently throughout the 1960s and 1970s.\(^\text{14}\) The United States government supported Pakistan during the war in 1971, but the relationship soured, ushering in a decade of poor relations and heightened nuclear rivalry between India and Pakistan.\(^\text{15}\) Pakistan’s relentless pursuit of nuclear weapons during this period strained diplomatic relations with the United States.

The relationship was transformed in 1979, however, when the Soviet Union invaded Afghanistan. U.S. officials viewed Pakistan as the only bulwark in the region against the Soviets, and negotiated a five-year, $3.2 billion economic and military aid package with Islamabad to ensure Pakistani support for the United States in the region. This aid repaired the rupture temporarily, as the United States came to rely on the Inter-Services Intelligence (ISI) to funnel equipment to rebel fighters in Afghanistan.\(^\text{16}\) Despite this strong diplomatic relationship, the U.S. Congress was concerned about Pakistan’s nuclear weapons. After the Soviet withdrawal in 1989, President George H. W. Bush declined to certify that Pakistan did not possess a nuclear weapon, triggering automatic aid cuts under the terms of the 1985 Pressler Amendment.\(^\text{17}\)

The United States remained largely disengaged from Pakistan throughout the 1990s and imposed sanctions in the late 1990s when Pakistan conducted nuclear tests. U.S. officials were also wary of Islamabad’s support for the Taliban, who had taken power in Kabul in 1996. The ISI was suspected of providing the Taliban with technical advisers and military equipment.\(^\text{18}\) The United States, in a break from its hands-off policy, pursued an active role during the Kargil crisis of 1999, when Indian and Pakistani troops skirmished along the heavily disputed line of control (LOC). President Bill Clinton conducted negotiations with Prime Minister Nawaz Sharif in an effort to draw Pakistani troops back from the border.\(^\text{19}\) After the 1999 crisis, U.S. attention to Pakistan waned until September 2001.


\(^{15}\) Cohen, “Pakistan and the Cold War,” p. 78.

\(^{16}\) Ibid., p. 79.


Civilian Assistance after 2001

The vicissitudes of U.S. aid to Pakistan has led many Pakistanis to resent the United States. Indeed, many now blame the current bout of violence and terrorism on U.S. disengagement during the 1990s. For instance, former president Musharraf repeatedly blamed the United States for leaving Pakistan “abandoned totally” and also claimed that the United States “bungled up” victory in Afghanistan.20 Many Pakistanis felt “used and ditched,” and some went as far as to blame the disengagement for more recent problems: President Asif Zardari of Pakistan wrote in 2009, “Frankly, the abandonment of Afghanistan and Pakistan after the defeat of the Soviets in Afghanistan in the 1980s set the stage for the era of terrorism that we are enduring.”21 Pakistanis view the United States as an unreliable partner because of the unpredictability of U.S. civilian and military assistance.

Between 2001 and 2011, the United States spent over $8.8 billion in nonmilitary assistance to Pakistan.22 With the greatest spending in 2002 and after 2009,23 aid flows to Pakistan have been associated with U.S. attention toward Afghanistan. Much of that increase was the result of the Kerry-Lugar-Berman (KLB) bill, which authorized a tripling of civilian aid for the 2009–2014 period.24 After the withdrawal of U.S. troops from Afghanistan and the expiration of the KLB act in 2014, civilian aid is expected to decline precipitously.25

Civilian aid to Pakistan since 2001 has been largely unsuccessful from a development perspective:26 “by most objective measures, U.S. assistance to Pakistan since 2001 has not achieved its central goals.”27 Washington policymakers have the perception that “billions of taxpayer dollars have neither won hearts and minds nor achieved full buy-in for combating terrorism and stabilizing Afghanistan.”28 Civilian aid often works at cross purposes with the much larger military aid program, as security assistance strengthens the very military bureaucracy that impedes democracy and governance programs funded through civilian aid.29 Civilian assistance is allocated to Pakistan in large part based on U.S. military calculations, as a long-time quid pro quo for Pakistani cooperation with U.S.
policy in Afghanistan. Concerns about local partners, the poor security situation, and congressional oversight have led USAID to delay disbursement of funds, and hastily reallocate funds to less effective programs. Other organizational problems in USAID decrease the effectiveness of aid. As an example, the separation between USAID’s energy and economic growth programs pulls money away from the important economic growth program, which could help youth unemployment, for the energy program’s highly visible dam projects.

**Military Relations after 2001**

Since 2001 the United States has allocated approximately $17 billion in military support for Pakistan, of which $10 billion is reimbursement to Pakistan for supporting U.S. military activities through the Coalition Support Fund (CSF). Other major military assistance programs are the $2.7 billion Pakistan Counterinsurgency Fund/Counterinsurgency Capability Fund, and the $2.75 billion Foreign Military Financing program.

The Pakistani military has often not spent assistance money in line with U.S. desires. Much of the Coalition Support Fund money is disbursed directly to Pakistani ministries, with no continuing oversight of how it is spent. U.S. assistance money intended for counterterrorism or counterinsurgency activities was frequently spent on weapons that are only useful for conventional military engagements, including fighter aircraft, anti-ship missiles, missile defense, radar equipment, and hundreds of air-to-air missiles. In response to Pakistani unwillingness to fight insurgents in Pakistan, the U.S. Congress created the Pakistan Counterinsurgency Fund in 2009 to target aid more directly to Pakistani forces operating in the Federally Administered Tribal Areas (FATA) and the Swat Valley. In 2011, after Pakistan expelled U.S military advisers and closed Pakistani borders to U.S. military convoys, the United States withheld $1 billion in CSF money and $700 million in counterinsurgency money. U.S. government officials have also considered cutting off aid to pressure Pakistan into ending its support through the ISI for the Haqqani network and other anti-U.S. organizations.
Trade and Trade Agreements

The United States has always been an important trading partner for Pakistan. As Figure 1 shows, Pakistani exports to the United States on average have grown year after year from 1999 through 2012. The United States has been the largest export market during many of the years. On average 20 percent of exports were U.S. bound since 2003. The largest export categories are textile related. The United States is also one of the largest import partners for Pakistan. The largest import categories are essential for Pakistan because they are mainly inputs into Pakistani manufacturing or for aircrafts, arms, and ammunition.

Before 2001 there were no major trade agreements between the United States and Pakistan. Textile concessions dominated the debate because textiles are Pakistan's main export to the United States. The Multi-Fibre Arrangement (MFA) was implemented under the World Trade Organization (WTO) to protect the textile industries of developed countries from competition from low-wage developing countries. In 1995 the agreement was supplanted by the Agreement on Textiles and Clothing, governing the gradual phase-out of textile controls over the following 10 years. In 1996 the United States attempted to impose restrictions on Pakistani exports of cotton yarn to the United States, but was deterred by the terms of the agreement. In 1998 the United States announced to Pakistan that it intended to impose restrictions again. This time, bilateral negotiations failed and the dispute went to the WTO’s textile monitoring body, which ruled in favor of Pakistan in 1999. The United States refused to lift the restrictions, causing the case to go to the WTO’s Dispute Settlement Board. The board ruled in favor of Pakistan in April 2001, causing the United States to lift restrictions in November 2001. The Agreement on Textiles and Clothing was phased out in 2005. Textiles are now governed by the general rules of the WTO. This is a contentious issue in Pakistan and is discussed later.

The United States has considered a number of trade concessions and trade assistance for Pakistan since 2001 but follow through is considered lacking. The two countries signed a Trade and Investment Framework Agreement (TIFA) in June 2003. This agreement provided a framework to examine ways to expand bilateral trade and investment. More exactly, TIFA created a joint council that considers a diverse array of commercial

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47. Ibid.
48. Ibid.
49. Ibid.
issues and encourages trade and investment between the two countries. The United States and Pakistan have been negotiating a bilateral investment treaty (BIT) since 2004, with the goal of ensuring good investment climates and that foreign companies are treated as favorably as domestic companies. The purpose of the BIT would be to play “an important role in strengthening Pakistan’s economy, so as to create new opportunities for exporters and investors in both economies and assist in meeting the economic conditions to counter terrorism.” Talks have stalled over which body would arbitrate disputes between U.S. and Pakistani companies. Pakistan is reluctant to sign the BIT because of the

U.S. demand that Pakistan accept the Washington-based International Center for Settlement of Disputes (ICSID) as a third-party arbiter in case of business disputes. While agreeing to have an arbitration clause, Pakistan prefers that dispute resolution be handled by the United Nations Commission on International Trade Law (UNICITRAL), based in Vienna, Austria.\textsuperscript{54}

\textsuperscript{54} Ibid.
Findings

Most of the Pakistanis, and many of the Americans, interviewed for this study said they believe the relationship between the United States and Pakistan has always been primarily a military-to-military relationship rather than people-to-people. Almost all of the Pakistanis said they thought the United States only prioritizes Pakistan because of external factors such as the Soviet invasion of Afghanistan or their need for assistance after September 11, 2001.1

The research discovered that until 2014, Pakistan and the United States will engage with one another out of necessity, and much of the engagement will be centered on security. Beyond 2014 future cooperation will depend on U.S. interests and policies toward South Asia. While most interviewees believed that the United States and Pakistan would maintain some semblance of a relationship, they differed vastly on the scope and extent of post-2014 cooperation that they believed was likely.

Most argued that Pakistan will remain a U.S. priority for a number of reasons:

- the presence of nuclear weapons in Pakistan
- interest in avoiding spillovers and contagion from conflict and instability in the region, specifically in regard to Pakistan’s geographical position as a potential buffer between Central Asia’s potential instability and the rest of South Asia2
- Pakistan’s ability to become a “substitute”3 Afghanistan by giving al Qaeda and other extremist groups a sanctuary from which attacks can be planned against U.S. targets
- Pakistan’s growing market for consumer products, especially for imports from the United States4
- the ongoing debate within Pakistan between those who support democracy and those who support Islamist political ideology5

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2. Aziz Khan, former Pakistan ambassador to India, author interview, Islamabad, January 2013; Maria Sultan, director, South Asian Strategic Stability Unit, author interview, Islamabad, January 2013.
5. Feisal Neqvi, author interview, December 2012.
Very few interviewees believed there would be active U.S. disengagement from Pakistan after 2014. Some argued that the United States would disengage in the unlikely event that extremist groups were to overpower the state. More likely, it would distance itself from Pakistan if extremist groups operating from Pakistan were to attack Indian and U.S. targets and there was a perception that the Pakistani military had not been doing enough to counter violent extremism. Even if a terrorist attack with roots in Pakistan took place, many interviewees believed the relationship would not be adversely affected as long as Pakistan is proactive in countering the militant groups or perceived as tackling the problem of extremism aggressively. The United States is likely to pay careful attention to the way the Pakistani state apparatus deals with radicalization in the coming years.

Several points of contention have been identified. Areas for growth, opportunity, and collaboration have also been identified which can repair and strengthen the relationship between Pakistan and the United States.

Points of Friction

PAKISTAN’S INTERNAL CHALLENGES

All the Pakistanis consulted for this project agreed that the problems in the relationship are not one-sided. To improve relations with the United States, or for that matter any country, they argued that Pakistan needs to put its own house in order. Pakistan has not been perceived as a “mature” partner for the United States. Its internal problems, such as terrorism, not only affect the relationship but also threaten stability. If Pakistan continues on its current internal trajectory, given its dismal macroeconomic performance, then the possibility for a dynamic and mutually beneficial relationship with the United States will be almost impossible. In economic terms (i.e., on investment and trade) Pakistan stands to be completely marginalized. If Pakistan stabilizes internally, however, it will move closer toward the United States as its democratic institutions improve and as education levels increase.

Neighboring countries are deeply concerned about Pakistan’s internal stability as well. China issued three warnings to Pakistan during 2012 about the Uigher militant movement,

8. Sarwar Naqvi, former Pakistan ambassador to IAEA and Austria, author interview, Islamabad, December 2012; Rasool Bakhsh Rais, Lahore University of Management Sciences and Journalist, author interview, Lahore, January 2013.
stating that it suspected the movement received support from elements in Pakistan.\textsuperscript{13} India and Iran are worried about contagion and the spillover effects of local insurgencies, such as the fighting in Balochistan. Policymakers in both countries are focused on ways to help keep Pakistan stable.\textsuperscript{14} Some interviewees felt that the international community in general is more concerned with Pakistan's internal stability at present than Afghanistan's.\textsuperscript{15} At the same time, Pakistan is also worried about diplomatic isolation.\textsuperscript{16}

\textbf{MUTUAL DISTRUST}

Distrust runs strong in the relationship between Pakistan and the United States. For example, the United States sees Pakistan’s support for groups, such as the Haqqani network, that actively target American interests in Afghanistan as double-dealing. Pakistanis fear abandonment after the 2014 U.S. withdrawal from Afghanistan, which would be a repeat of the way the United States abandoned the region after the Soviet withdrawal in the early 1990s. Pakistanis also see a string of broken promises on committed civilian and military aid that was never delivered.\textsuperscript{17} The issue of cross-border sanctuaries is an irritant for both countries: while the United States and Afghanistan feel that Pakistan does not do enough to combat Pakistani militant groups in North Waziristan, Pakistan feels that Afghanistan and the United States are not doing enough in Kunar, where wanted elements of the Tehreek-e-Taliban Pakistan (TTP) such as Maulana Fazlullah are based and are launching attacks on Pakistan.\textsuperscript{18}

Both countries would like better border management, but findings ways to actually collaborate has proven challenging.\textsuperscript{19} Some steps have been taken, a sign of hope. Following the 2011 Salala incident there are now systems in place that allow both sides access to information when there is movement near check posts.\textsuperscript{20}

U.S. covert operations in Pakistan are a major irritant for many Pakistanis. Some people in the military and government believe the United States means to denuclearize Pakistan covertly. The Raymond Davis issue\textsuperscript{21} has also forced covert operations into the public eye.\textsuperscript{22} The Central Intelligence Agency (CIA) station in Islamabad is believed by Pakistanis to be the largest in the world (although this information is classified by the CIA)

\begin{thebibliography}{99}
\bibitem{13} Rashid, author interview, January 2013.
\bibitem{14} CSIS Roundtable, Lahore, January 2013.
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\bibitem{18} Zahid Hussain, journalist and defense analyst, author interview, Islamabad, December 2012; Ejaz Haider, Journalist author interview, Islamabad, January 2013.
\bibitem{19} CSIS Roundtable, Islamabad, January 2013; senior Pakistani army official, author interview, January 2013.
\bibitem{20} Senior army official, author interview, January 2013.
\bibitem{21} Raymond Davis was a CIA contractor who shot two men in Lahore, Pakistan and caused the death of another civilian. While the Pakistani government argued that he was a CIA contractor the U.S. government said that he had immunity because he was a diplomat. It later became public news that he was indeed a CIA contractor.
\bibitem{22} CSIS Roundtable Lahore, January 2013; Raza Rumi, author interview, Islamabad, January 2013.
\end{thebibliography}
and unknown to the general public). Many worry generally about a lasting CIA footprint. Interestingly, Pakistani scholars interviewed for this project did not mention drones as a direct irritant in the relationship. The effect of drones on bilateral relations, they said, came through public opinion. Drone strikes are unpopular and fuel anti-American attitudes that cannot be ignored by political elites. Anti-Americanism is very high in Pakistan. When the U.S.-Pakistan relationship was at its worst in 2012, 74 percent of people polled viewed the United States as an “enemy” of Pakistan. Many civil society members said the drone operations should be done in conjunction with the relevant Pakistani authorities, rather than operated by Americans. Technical and trust issues aside, Pakistan’s parliament has passed a resolution condemning drone strikes; any change in that position would likely trigger a public opinion backlash.

In fact, one of the largest obstacles to successfully resetting the U.S.-Pakistan relationship is public opinion. Because a majority of Pakistanis continue to view the United States through a negative lens, the Pakistani government and military are restricted from cooperating with the United States in a constructive way. Conversely, the United States will find it difficult to assist Pakistan if too many Americans believe Pakistan is a hotbed of anti-American extremism.

**THE FUTURE OF THE AFGHAN GOVERNMENT**

Pakistanis worry that the United States will leave the region without a legitimate and viable political settlement in Afghanistan. Civil war in Afghanistan after 2014 would be disastrous for Pakistan. It would result in more refugees. Any insurgency originating from the tribal areas would be bolstered, furthering spillover and contagion. The possible breakup of the Afghanistan National Army along ethnic lines due to civil war would have far worse consequences than was the case in the 1990s, because each ethnic group is now better armed and trained.

Pakistanis also fear that, without political inclusion, the Taliban will turn their focus toward Pakistan and fully support the TTP. The ideal scenario for all countries in the region, according to many interviewees in Pakistan, would be a political settlement that includes the Taliban, the Northern Alliance, and other significant political actors in the

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30. There has been a lot of debate recently about how different or allied the Pakistani and Afghan Taliban are.
formal process. For successful settlement, there would need to be changes to the Afghan constitution that would allay the fears of other ethnic groups, such as providing more autonomy to the provinces so that the ethnic groups have more influence in their area. Pakistanis are worried whether a credible successor will be chosen after President Hamid Karzai and whether the resulting new Afghanistan government will want to work with Pakistan and look after Pakistani interests too.\footnote{31}

At the same time, there are concerns over the repercussions of a rigged election in Afghanistan in April 2014. If President Hamid Karzai secures the succession of a favored crony who does not represent the interests of other groups in Afghanistan, there is a fear of a north/south or Pashtun/non-Pashtun divide in the country. Several interviewees expressed concern that the North Atlantic Treaty Organization (NATO) and the United States are not putting in enough effort to ensure free and fair elections.\footnote{32}

**DISAGREEMENT OVER TALIBAN ENGAGEMENT**

Pakistan and the United States remain divided on the issue of how to engage with the Afghan Taliban. The United States has designated the Haqqani network as a foreign terrorist organization (FTO) and has been pushing Pakistan to do more against them in North Waziristan.\footnote{33} However, there are two issues at play. First, unlike the United States, Pakistan believes that talks with the Afghan Taliban should include the Haqqani network. Second, on the operational side, there are serious implications of any military action against the Haqqani network on Pakistani soil. The Haqqani network is predominantly Pashtun and military action against them would pit Pashtuns against each other. Furthermore, many Pakistanis feel that this would be an asymmetrical war because Pakistan does not have the capacity to fight the Haqqani Network in their strongholds of North Waziristan, while the extremist network has shown its capability to hit when it wants in any part of Pakistan.\footnote{34}

There is also disagreement about the place for the Haqqani network in an Afghan political settlement. While the United States is hesitant to engage with them, many Pakistani policymakers do not believe that there can be a viable political settlement without them. Some believe the Haqqani network would not act as a spoiler to any peace brokered by Mullah Omar and the Quetta Shura.\footnote{35} Ultimately, in this view, Haqqani members are Afghans and would stand by Mullah Omar and any settlement he agrees to.

There are also differing views of Pakistan’s ability to, as many have described it, deliver the Taliban to the negotiating table. While almost everyone agrees that there is some role for Pakistan to play in negotiations with the Taliban, there were differences in opinion...
of the extent to which they can assist. Some argued that Pakistan has a limited ability because the Afghan Taliban have come to resent the Inter-Services Intelligence (ISI) and Pakistan. 36 The Taliban do not have confidence that Pakistan has their best interests at heart and believe that Pakistan has micromanaged their decisions. 37 Most importantly, they want to disprove their image in Kabul that they are “stooges of Pakistan.” 38 However, the majority view is that Pakistan can in fact deliver the Afghan Taliban to the table because the Taliban are pragmatic. They are housed in Pakistan and know that for their own safety after 2014 they will need an amenable Pakistan. 39

For a viable political settlement, however, Pakistan needs to allow the Taliban freedom to talk without putting restrictions on them as has been done in the past. 40 There are some positive indicators. Pakistan and Afghanistan have been talking to each other on a bilateral level far more since 2012. Prior to this, most communication was coordinated through the United States. Pakistan also released seven Afghan Taliban prisoners in November 2012. 41 There is general consensus that there needs to be a collective effort (involving Turkey, Central Asia, Saudi Arabia, and other countries that have influence on the region) to put pressure on all parties involved. 42

U.S. TROOPS IN AFGHANISTAN BEYOND 2014

Most Pakistanis interviewed for this project felt that the U.S. troop presence post-2014 needs to be strong enough to ensure stability in Afghanistan. 43 They doubted that the Afghan National Security Forces (ANSF) would be adequately equipped and trained to maintain stability on their own. 44 However, a few wanted no U.S. troops to remain in Afghanistan, believing that continued involvement of the United States would only damage U.S.-Pakistan relations further; those individuals were particularly suspicious of U.S. intentions in the region, some claiming they feared the purpose of leaving a small number of troops in Afghanistan would be to position them to attack Pakistan. 45 But this was a concern expressed only by a small minority of participants.

Potential Opportunities

CIVILIAN ASSISTANCE

Between 2001 and 2011 the United States spent over $8.8 billion in nonmilitary assistance in Pakistan. Aid flows to Pakistan since 2001 have been associated with U.S. attention on Afghanistan. Aid flows were high in 2002, immediately after the invasion of Afghanistan, and again after 2009 with the passage of the Kerry-Lugar-Berman (KLB) Act. Known as the Enhanced Partnership with Pakistan Act (EPPA), it pledged the release of $1.5 billion for high-impact, high-visibility projects through 2014. The United States hoped to work on rehabilitating projects that could begin right away. Richard Holbrooke, then special representative to Afghanistan and Pakistan, had especially pushed for water, energy, and food infrastructure projects that would increase mutual trust.

Despite good intentions, the KLB Act was difficult to get off the ground. Officials in Washington scrambled to come up with transfer mechanisms that would protect the disbursed aid from high levels of corruption in the Pakistani government. High-impact projects were announced but delayed, sowing confusion among many in Pakistan who thought that important infrastructure projects would begin immediately. The volatility of U.S. aid and the broken promises for important deliverables have, for many Pakistanis, served as a test of Washington’s sincerity.

There are several problems with the current system of aid distribution. Corruption has certainly hindered the distribution of aid and civilian assistance, a fact that Pakistanis acknowledge. Several interviewees pointed to corruption in the government as the main reason U.S. civilian assistance was not achieving the set goals. Others pointed to political in-fighting in the U.S. Agency for International Development (USAID) bureaucracy and a lack of cohesive programming. Many pointed to structural problems in program designs that led to unintended consequences. The Fulbright program, for example, allocated 500 scholarships for Pakistani students to study at universities in the United States, but almost always at full cost. It also promoted “brain drain,” pulling the highest achieving students out of Pakistan. Others interviewed suggested that civilian aid is simply going through the wrong channels to have an effect on poverty. Many believe that channeling money through the government is inefficient because of corruption and inadequate capacity to deal with large amounts of aid money.

47. In constant 2011 dollars. U.S. Overseas Loans and Grants (Greenbook).
51. Ibid.
52. CSIS Roundtable, Lahore, January 2013.
Despite these problems with the disbursement of U.S. civilian aid, there are examples of good programs (see the USAID Teacher Education Program text box).

After the withdrawal of U.S. troops from the region and the expiration of the KLB Act in 2014, civilian aid is expected to slowly decline. The United States has a vested interest in continued civilian programming: a stable Pakistan and a stable region. Civilian aid may also be given to assist in legitimizing the writ of the state and the government. For example, a comprehensive education project is currently being negotiated with the Higher Education Commission of Pakistan.

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**USAID Teacher Education Program**

The USAID Teacher Education Program (formerly called Pre-STEP, for Pre-Service Teacher Education Program) works across sectors to implement reforms to pre-service education. It is generally viewed as successful, and serves as an example of programming with reduced civilian assistance. The Teacher Education Program recognized complexities and tackled a wide array of issues, including service structure, curriculum, quality assurance, and administrative training—while working with multiple levels of government and different implementing partners. The execution mechanism was through a large well-funded project implementation unit in Pakistan that had great leadership. The Higher Education Commission of Pakistan is a partner in this project. The success of the program can be attributed to their sensitivity to local dynamics, but mostly to patience. The program has been ongoing for five years. Leaders recognize that it takes time to build capacities and they have not forced leapfrogging of results.\(^5^4\)

The program has several achievements: (1) the development and implementation of a two-year associate degree for primary and secondary school teachers; (2) the development of community colleges to provide more opportunities for enrollment in this degree; (3) a more comprehensive four-year degree program; (4) capacity building so universities can provide the more comprehensive four-year program; (5) reframing the entire structure of the pre-service education; and (6) collaboration with provincial governments so hiring and promotion criteria was redesigned to reflect the changed structure. In Punjab, for example, to get hired as a teacher the associate degree programs are now the preferred way.\(^5^5\) Also, an external body (the National Education Council for Teacher Education [NACTE]) was set up to provide a formal structure of quality assurance for certification of education programs for teachers after consultations with the provincial education departments.

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\(^{54}\) Sohail Neqvi, author interview, January 2013.

\(^{55}\) But not the only way.

\(^{56}\) Rais, author interview, January 2013.
Education Commission of Pakistan for approximately $160 million. The United States also has a vested interest in continued aid because Pakistan is slowly becoming more democratic. The Pakistani military’s power is slowly decreasing and citizens are demanding more from their government. Most interviewees agreed that, despite the falling dollar amount of civilian aid to Pakistan, programs could still be effective if well designed. A number of stakeholders believed that U.S. civilian assistance could be used more transparently and efficiently if it were given directly to the private sector, particularly job-creating organizations. Department for International Development (DFID) of the UK currently uses this model, and some believe that it is more successful. However, the mix in the manner of providing assistance (directly to government or to the private sector) will depend on U.S. objectives in the future. Previously, aid has been channeled through the government to help provide legitimacy. If the United States is clear on its objectives, it can choose the appropriate mix between channeling aid to the government or working more directly with civil society organizations and the private sector. Certain initiatives show the potential for USAID to engage successfully with nongovernmental actors.

One such initiative is USAID’s gender equity program, working on the ground with the Aurat Foundation. The Aurat Foundation, in partnership with the Asia Foundation, distributes USAID grant money to governmental and nongovernmental organizations working on women’s equality. This example of USAID funding is targeted and works directly with local partnerships. This is an alternative to offering lump sums directly to the Pakistani government or working on large-scale infrastructure projects.

ELECTIONS IN PAKISTAN

Interviews and roundtables were held in Pakistan from December 2012 to February 2013. Many people were doubtful whether elections would take place as planned in 2013. Pakistanis feared that the outcome of the election would be a highly fragmented government similar to the previous one. As a result, decisionmaking would be extremely challenging and would not bode well for Pakistan’s internal problems. As mentioned earlier,

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57. USAID administrator Rajiv Shah announced the National Reading Program in April 2012 during a visit to Pakistan. The program intends to reach seven million children by improving assessments and teacher training and restructuring schools. The program intends to measure success by assessing reading skills at the end of the project, not only the number of students who complete schooling. The press release for the program announcements notes that only 40 percent of primary school graduates can read a sentence in their native language. The program does not appear to have started. The initial deadline on proposals to implement the program, worth $160 million under a cooperative agreement, was extended to December 15, 2012. USAID expects to award the five-year cooperative agreement some time in 2013.


61. Rashid, author interview, December 2012.

internal upheaval would affect the U.S.-Pakistan relationship different ways. It would also have made decisionmaking on cooperation with the United States more difficult.

Though the election results show that the Nawaz Sharif government is not as fragmented, the outcome is still equally important. The incoming government is led by the Pakistan Muslim League–Nawaz faction (PML-N).63 Nawaz Sharif and his party have historically bad ties with the Pakistan army. Cohesion between civilian institutions and the army will be vital for ensuring Pakistan’s internal security and stability. At the time of writing this report, both the civilian apparatus and the army appear to be trying to work together. Going forward, the civilian-military balance and relationship will be important for the United States and its withdrawal from Afghanistan.

ENERGY PROJECTS

Pakistan is facing a large energy crisis that is affecting not just economic activity but also the everyday lives of citizens. The energy deficit is expected to increase; there appear to be few options to solve the crisis. Iran and Pakistan signed a deal in Turkey on March 16, 2010, confirming agreement to construct a gas pipeline. During the interviews and roundtables, construction on the Pakistan side had not begun. There was immense pressure from the United States for Pakistan to seek alternatives to the pipeline. The alternatives offered by the United States were considered unviable and would not come close to meeting the deficit or provide the amounts of energy that the proposed Iran-Pakistan gas pipeline can.64 Many people cited this as an example of the United States’ disregard for helping Pakistan with its internal affairs. In March 2013 President Mahmoud Ahmadinejad of Iran and President Asif Ali Zardari inaugurated the pipeline project at the start of construction on the Pakistani portion of the pipeline.65

At the time of this writing, there has not been a serious outcry about its launch from U.S. policymakers.66 One reason for the lack of a stronger response could be that the pipeline has started and stopped so many times in the past that the United States may just be waiting until it gets further to talk more seriously about sanctions.67 If the United States remains quiet and allows construction to go forward, it will likely be viewed

63. The main opposition parties are the Pakistan Tehreek-e-Insaf (PTI) led by Imran Khan and the Pakistan’s Peoples Party (PPP).
64. CSIS Roundtable, Lahore, January 2013.
66. One statement was made in early March, when a State Department spokesperson said that the pipeline would raise “serious concerns under our Iran Sanctions Act”; see Scott Neuman, “Pakistan Begins Construction of Pipeline Link with Iran,” NPR, March 11, 2013, http://www.npr.org/blogs/thetwo-way/2013/03 /11/174003303/pakistan-begins-construction-of-pipeline-link-with-iran. Also “we have serious concerns if this project actually goes forward that the Iran Sanctions Act would be triggered”; see Scott Stearns, “US Considers Sanctions against Pakistan for Iran Pipeline,” Voice of America, April 2, 2013, http://www.voanews .com/content/us-considers-sanctions-against-pakistan-for-iran-pipeline/1633012.html.
in Pakistan as a goodwill gesture that could help stabilize Pakistan and its energy crisis.\textsuperscript{68}

While the United States obviously cannot fulfill all of Pakistan’s energy needs, it has provided a good deal of support already. There is not enough recognition of the work that has been done, which some interviewees attributed to bad public relations strategies by the United States. For example, Richard Olsen, U.S. ambassador to Pakistan, recently announced that the USAID would finance the “due diligence feasibility study” for the Diamer Bhasha Dam. USAID agreed to donate $20 million toward the feasibility study.\textsuperscript{69} If construction of the dam begins the United States may help finance the Diamer Bhasha Dam with $2 billion spanning eight years.\textsuperscript{70} Among the list of potential donors is the Asian Development Bank, which has also been trying to convince the World Bank to match its expected donation of $2.5 billion.\textsuperscript{71} The World Bank has been leery of providing funds because India has claimed that the dam would be built on disputed territory.\textsuperscript{72} U.S. backing for the dam may ease this concern.\textsuperscript{73} Yet on the day that these announcements were made it was only back-page news in the Pakistani press.\textsuperscript{74} Although building the dam has been delayed and the construction has been challenging, it does show some degree of U.S. commitment to the long-term economic health of Pakistan. It likely would have mitigated some anti-American views in Pakistan if it had been front-page news. Some U.S. policymakers have argued that they have spent a large amount of effort on public diplomacy in Pakistan. The interviews suggest Pakistani scholars and policy makers do not think those efforts have been effective.\textsuperscript{75}

INDIA

Pakistan is beginning to have a more realistic appreciation of U.S. engagement with other countries in South Asia, such as India.\textsuperscript{76} Many Pakistanis are now openly admitting that India is simply a much larger player in the global order in every aspect.\textsuperscript{77} And though there is increased cooperation and hopeful indicators for better relations between Pakistan and India, Pakistan still has apprehensions about India’s role in Afghanistan. Most Pakistani policymakers seem to be coming to an acceptance that India will play at least some role in Afghanistan.

\textsuperscript{68} CSIS Roundtable, Islamabad, January 2013; CSIS Roundtable, Lahore, January 2013; CSIS Roundtable, Karachi, December 2012.


\textsuperscript{72} Ibid.

\textsuperscript{73} Rana, “Diamer Bhasha Dam.”

\textsuperscript{74} Feisal Neqvi, author interview, December 2012.

\textsuperscript{75} CSIS Roundtable, Washington, DC, June 2013.


\textsuperscript{77} CSIS Roundtable, Karachi, December 2012; Fatemi, author interview, December 2012; Amir, author interview, December 2012.
Still, some Pakistanis worry the United States will cooperate with India to the detriment of Pakistan after 2014. At a structural level, there is a growing disparity between India’s and Pakistan’s economies and a growing connection between Indian and U.S. markets (India has already invested about $3 billion in the United States). Some Pakistanis worry that over the next 15 years U.S. South Asia policy will become increasingly India-centric.78 Many people are of the opinion that this also makes sense because the two countries are interested in constraining China’s economic and military buildup. Many thought that India will never want to be seen as a proxy for the United States as it wants to be a major player in its own right and because its own trade relationship with China is very large. For example, as part of its political diversification efforts, India bought 126 fighter jets from Europeans, even though the United States was willing to provide them.79 Other than possible economic rivalry, India is likely to want friendly relations with China, which is a key buyer of Indian goods.80 In fact, India is likely to advise the United States to be cautious when it comes to its own rivalry with China.81

TRADE AND ECONOMIC TIES

The most promising aspects for the U.S.-Pakistan relationship have been identified to be trade and economic cooperation. Stakeholders identified a number of issues and challenges that were thwarting greater economic cooperation.82 Visas for Pakistani businessmen were mentioned on numerous occasions. Access to markets in the United States was identified as a challenge as well.

The focus of a lot of the access issues was on textiles. Pakistan had market access in the United States during the 1980s and 1990s for textiles and garments. However, this was not supposed to be preferential continued access for an indefinite period, as Pakistanis desire. The Multi-Fibre Arrangement (MFA) (see Chapter 2) gave countries such as Pakistan access and reduced barriers specifically so that those countries could have time to move up the value chain and produce more sophisticated and lucrative derivatives of textiles. Pakistan, under the World Trade Organization (WTO) rules, was supposed to move from producing 29-knot cloth (lower value) to 12-knot cloth (higher value). Pakistan has been unable to do this. Thus, even if Pakistan has 26 percent market share of the global production for yarn, it is not a product that the United States needs or wants. The United States has reduced nontariff barriers on value added exports (knitwear and ready-made garments) but the barriers remain high because of the high standard requirements. Most knitwear and ready-made garments need to be brought up to standard, otherwise it will naturally be difficult for the United States to justify continued access. Pakistanis do realize that there needs to be more diversification in the economy and believe that the United States could benefit from engaging with its entrepreneurs.

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78. Khokar, author interview, December 2012.
80. CSIS Roundtable, Lahore, January 2013.
82. The security situation for FDI from the United States is a given and is not discussed here.
While Pakistanis think bilateral investment treaties (BITs) could prove beneficial for the economy, many policymakers remain hesitant about this opportunity. Negotiating BITs is tricky in many developing countries, not just in Pakistan. The challenges identified to signing a BIT were a number of problematic clauses in the treaty, such as the option of arbitration even after a decision of the Supreme Court of Pakistan, as had happened in the notorious Cotecna case. U.S. officials also wanted Pakistan to give 90 days’ advance notice in case any new laws related to foreign investors were introduced into the country, which was perceived as being against the U.S. president’s constitutional right to issue any ordinance at his discretion.

There is growing recognition even among U.S. policymakers that engaging with the Pakistani private sector for job creation is important. For example, the United States is designing the Pakistan Private Investment Initiative (PPII). PPII is intended to encourage private sector growth and job creation needed to combat growing unemployment. PPII will partner with investors to provide capital for small and medium sized enterprises (SMEs) in Pakistan and to develop an investment model for sustainable development in Pakistan after the program’s completion. PPII has not been launched yet; PPII is still seeking partner investment funds who will agree to at least match dollar to dollar USAID’s investment in the program and preferably more. The terms of the grant have not been changed. USAID expects to grant an estimated four awards, and the total program funding is approximately $76 million. The maximum award that will be given to an investor is $24 million. PPII is expected to last 10 to 12 years, with a five-year period in which to make investments and a five- to seven-year period until investments will be liquidated. The program has been delayed.

The United States and Pakistan have a strong trade relationship, despite the ups and downs that have occurred over the last few decades. The individuals who expressed the most hope for successful relationship between the two countries were businessmen. There was near consensus across all stakeholders that increased economic activity between the two countries would prove the most viable option for future cooperation. Pakistan is
resource-rich with innovative entrepreneurs who are trying to break into international markets. Thus, increased economic cooperation could prove beneficial to the United States as well. It could also contribute toward a more stable Pakistan, especially given the current economic conditions and demographics. Most of the next chapter’s recommendations, therefore, focus on improved relations via Pakistan’s private sector.
The best way of achieving a sustainable positive relationship between Pakistan and the United States is to seek solutions that tie the well-being of citizens in both countries with each other. Outlined below are some avenues that, notwithstanding the continuing pressures and the possibility of unforeseen shocks that might divide the countries, could offer maneuvering space to those who would benefit most directly from improved cooperation.

Engage the Private Sector

Several trends are driving donors toward development strategies that depend on the private sector to achieve development outcomes. First, the resources for undertaking foreign development projects are contracting among most donors. Foreign aid by the Organization for Economic Cooperation and Development (OECD) countries fell 3 percent in 2011. This is the first decline in more than a decade, indicating a global contraction in spending on official development assistance (ODA). Second, countries, such as Pakistan, that are considered fragile or are experiencing armed conflict or high levels of violence have made less progress with ODA support than other countries. As a consequence, donors are seeking alternative approaches. The recognition that many countries have a functioning private sector has led to interest in studying how that sector can contribute to better development outcomes. It has been suggested that a functioning local private sector, one that remains active throughout a conflict, can quickly bring a “peace dividend” of jobs and trust-based relationships to a violent situation. Third, in some countries, including Pakistan, U.S. aid workers and the U.S. Agency for International Development (USAID)–branded projects are threatened by anti-American attacks.

Engaging with and working through local implementing partners have been suggested as a means to mitigate such risks.

In Pakistan, local companies often prioritize stability, infrastructure, better regulation, and lower corruption over increased foreign direct investment (FDI). U.S. policymakers often share those objectives. As a consequence, better coordination between the U.S. embassy and local companies could help target U.S. development work toward specific undertakings that promote local economic growth. Some international corporations already invest in fragile states, but some do not have access to much of the expertise and advice that U.S. embassy personnel could offer. Pakistan has a low level of FDI. Better dialogue between U.S. embassies and international companies working in fragile states, along with U.S. political risk insurance and targeted financial incentives, could encourage international investment in Pakistan. By working with local and international businesses to better target existing U.S. programs and by sharing U.S. embassy expertise with companies, U.S. policy can encourage self-sustaining economic growth using a strategy tailored to Pakistan even in the era of shrinking budgets.

Initiatives are being pursued, but only slowly and not at a scale that would bring significant change. The Pakistan Private Investment Initiative (PPII) is a good starting point, but it has still not been launched. Such programs should certainly be pursued and the possibility of scaling them up should be considered.

International investors are increasingly recognizing that, despite risks related to its conflicts and other internal challenges, Pakistan has surprisingly strong prospects for economic growth. It has a young population (56 percent under 21), a demographic that will consume more as it ages; rapid urbanization, which means concentrated markets; quickly growing consumer spending (7.5 percent compound annual growth rate [CAGR] since 2007); and a low percentage of small and medium enterprises (SMEs) with bank loans (7 percent), compared to 32 percent in Bangladesh and 33 percent in India, which indicates potential growth if more capital were available. Local companies have seen high growth (35 percent two-year median compound growth for the top-performing

5. Bray, “The role of private sector actors in post-conflict recovery.”
9. Ibid.
10. Ibid.
AllWorld Pakistan 100 countries). Large multinational corporations (Unilever, Colgate-Palmolive, Nestle) have seen much higher revenue growth in Pakistan than their global averages. The Karachi stock exchange’s low price-to-earnings ratio suggests the potential for higher dividends at lower cost. The Karachi stock exchange’s growth is only weakly correlated with U.S., UK, and Chinese markets, making investments in Pakistan good diversification tools.  

**Keep Engaging on Trade**

Although talks on the bilateral investment treaty (BIT) have stalled for legal reasons in Pakistan, the United States should stay engaged on this issue. It provides great opportunities for both U.S. businesses and the Pakistani economy. The newly elected government is focusing on economic and trade issues as a top priority. Given that BITs are facing issues in Pakistan because of challenges over the legal framework, the United States could provide technical assistance to help overcome these challenges, which will take time. In the interim other options such as free trade agreements (FTAs) should be pursued for mutual benefit. These FTAs should focus on Pakistan’s competitive industries and can help it diversify away from textiles.

**Direct Civilian Assistance toward Youth**

While Pakistan’s demographics favor growth, they also point to the need for immediate employment, without which there will be a growing pool of disaffected young people without a stake in a form of stability that offers them no opportunities. Anti-American protests draw on populations of unemployed young men. Violent groups often recruit young men who see no good economic future. Illiteracy and lack of social mobility prevent young people from finding jobs, while also constricting Pakistani economic growth. While Pakistan’s economy is growing at 3 percent per year, absorbing the growing young population will require 7 to 8 percent economic growth just to maintain employment. U.S. support for education programs might usefully focus on meeting this demand, for example, by focusing on skills development around competitive industries or SMEs where the most jobs are created and innovation occurs.

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Support Research into Energy Alternatives for Pakistan

Pakistan’s energy crisis is crippling its economy. USAID is paying for upgrades and repairs to dams and power plants, in addition to improving transmission and government regulation.\(^{16}\) Energy projects between 2008 and 2015 account for $180 million.\(^{17}\) The United States is also assisting through small hydroelectric dams. While this is helpful, it is important to keep in mind that these dams are expensive and face political challenges, mainly because they displace communities. The United States could pursue other less costly and more environmentally friendly options, such as solar and wind, though it would be difficult to do so in the absence of feasibility studies. It might make sense, therefore, to partner with other donors and Pakistan’s private sector to carry out feasibility and capacity studies for alternative energy solutions, similar to what USAID is doing for the Diamer Bhasha Dam. Given the diversity of Pakistan’s geography, different areas could support different solutions to its energy crisis.

Focus Infrastructure Spending on Private-Sector Needs

While the Kerry-Lugar-Berman (KLB) Act has provided support for infrastructure in the past, future efforts should be focused specifically on the needs of the private sector, particularly to support improved supply and value chains, and aligned with other U.S. programs that are supporting and promoting businesses in certain sectors.


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