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## Economics of Pak-Afghan Relations

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### Abstract

*This paper examines the economic relations between Pakistan and its neighbour Afghanistan in the context of Afghan President Hamid Karzai's visit to Pakistan in August 2013. These ties have been under strain for as long as Pakistan has been an independent state. Recognising that each country needs the other, a serious effort is being made by the leaders from both countries to find a common ground for working together. There are, however, major differences in the way Islamabad and Kabul would like to fashion their relations.*

### Introduction

President Hamid Karzai has a very limited time at his disposal. Between now and the spring of 2014, the country's Constitution demands that he must, after having served two terms, transfer power to another elected president. If that happens, it will be the first time that political power is

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transferred peacefully from one head of state to another in Afghanistan. The United States plans to pull out its troops from Afghanistan by the end of 2014, formally ending its involvement in the Afghan conflict after 13 years. Given this timetable, Karzai wants to leave a legacy. He wants to go down in the Afghan history as *the leader* who brought peace to a long-troubled country. To achieve that goal, he must find a way to work with the Taliban, a group of highly conservative Islamists who had ruled the country before Karzai became President. They would like to return to Kabul in some fashion or other. To accommodate the Taliban without surrendering the country to them, Karzai believes that he must persuade Islamabad to get the Taliban to the negotiation table.

Nawaz Sharif, the newly elected Prime Minister of Pakistan, has a different timeline and also different objectives in mind. He expects to be in power for at least five years, four of which will be coincide with a substantial part of the term of a new Afghan President. Sharif would like to keep his options open. He is also interested in developing a more productive economic relationship with the country to Pakistan's northwest than in solving the long-enduring political problems that have soured relations for so long between the two nations. But in domestic as well international affairs, politics cannot be separated from economics. One influences the other. There is much to be gained by working simultaneously in the two areas.

## **President Karzai's August 2013 Visit to Pakistan**

Pakistan had set the stage for the meeting with Karzai by sending to Kabul Sartaj Aziz, the veteran Pakistani diplomat who was Foreign Minister during Sharif's second tenure of Prime Minister (1997-99). Aziz is now the Foreign and National Security Affairs Advisor in Sharif's latest government. The Sharif government took some other steps as well to ease the tensions that had marred relations between the two countries. It encouraged the Pakistani side to play a soccer match against the national Afghan team in Kabul, an event that took place after a lapse of 10 years. Pakistan lost the match in front of a large and enthusiastic Afghan crowd. But a great deal of ground had to be covered to cast off the burdens of a troubled history of almost seven decades. From the time of its independence in 1947, Pakistan had found Afghanistan a hard neighbour to live with. The relationship was difficult for a number of seemingly intractable reasons, among them the 1893 "Durand line" arbitrarily drawn by a bureaucrat in London and designated as the boundary between British India and a weak Afghan state. The line had cut the Pakhtun areas, leaving a number of tribes and clans divided. That unhappy history notwithstanding, Pakistan's new Prime Minister believes that economics is a good tool to work with. In his first TV address to the nation as Prime Minister for the third time, Sharif had said, "We have to think afresh about Afghanistan. We have to devise a strategy which will enable Pakistan to be recognised as a new shining face all over the world". He gave no specifics but said that he was "keen to emphasize economic – and therein energy – denominator in the relations between the two countries".

Now, Karzai went to Pakistan hoping to get some help to move forward the stalled dialogue with Taliban. He took a large team of officials with him including the Afghan Finance Minister. The purpose of the mission was to explore cooperation in both politics and economics. Karzai focused on the political side, leaving the economic agenda to be managed by the finance minister. This was his first visit to the Pakistani capital in 18 months. It was also the first time Karzai was to meet Sharif since the latter's latest ascent to power. Karzai went to Islamabad on 26 August with the intention of staying in the Pakistani capital for only 10 hours. He had committed himself to only one meeting with Pakistan's new Prime Minister. In the event, he stayed instead for two days and met Sharif twice. The second meeting was held in Murree, a hill station in the Himalayas only 20 miles east of Islamabad. The fact that the stay was extended by one day created some hope but only for a brief period on the political side.

Not much was expected from his visit, and not much was achieved, at least in the political field. If any progress was made, it was in the area of economic cooperation. "Karzai has often accused Pakistan of providing shelter and support for Islamic insurgents seeking to undermine Afghanistan's stability", wrote Pamela Constable of *The Washington Post* in her coverage of the Afghan president's visit. She has covered both Pakistan and Afghanistan for her newspaper for many years and understands the two countries well. "He has visited Pakistan at least 18 times as president since 2002 but has always failed to secure meaningful cooperation in fighting terrorism reining in the Talibans".<sup>2</sup>

There was some speculation that the Afghan leader might return to Kabul, possibly accompanied by a freed Mullah Abdul Ghani Baradar who was languishing since 2010 in a prison in Pakistan.<sup>3</sup> Baradar once served as deputy to Mullah Mohammad Omar, who had presided over the Taliban regime in Kabul. Karzai believed that Baradar could be the bridge between the Karzai regime and the "Quetta Shura" in Pakistan. The latter functioned as a "government in exile" for the Taliban fighting in Afghanistan. If Karzai tried at all to win the release of the imprisoned Afghan leader, he did not succeed. But there were reports that Baradar himself was not enthusiastic about the role that was being assigned to him by Kabul. He presumably believed that any association with a regime that many in the ranks of the Taliban considered to have a short life expectancy would compromise him and hurt his future position. Pakistan facilitated a meeting between Baradar and Umar Daudzai, the then Afghan Ambassador in Islamabad. The former deputy to Mullah Omar was apparently unequivocal in not agreeing to play the role of an intermediary.<sup>4</sup>

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<sup>2</sup> Pamela Constable, "Karzai brings away little from Pakistan visit", *The Washington Post*, 28 August 2013, p. A11.

<sup>3</sup> Fahd Humayun, "Karzai in Pakistan: Tailoring great expectations", 28, August, 2013, Jinnah Institute, Islamabad.

<sup>4</sup> Najamuddin Shaikh, "The Karzai visit", *Dawn*, 28 August 2013, p. 7.

When Karzai arrived in Islamabad, the much-talked-about Afghan attempt to negotiate with the Taliban was totally stalled. There were serious differences between the two sides, some of them unexpected. When the Mullah Omar group was allowed to open an office in Doha, the capital of Qatar, it was meant to serve as the site for holding discussions on Afghanistan's future. But the Taliban had other ambitions. They offended Kabul by putting up a plaque at the rented building which announced that the Doha office represented the Emirate of the Islamic Republic of Afghanistan, the name they had given the country while they ruled over it from 1996 to 2001. They also flew the Taliban flag on the building. These acts were seen by Karzai as deliberate provocations by the Taliban leadership and were clearly not acceptable to Kabul or to the Americans. Even though these symbols of the Taliban rule over Afghanistan were removed, the intended negotiations did not begin. Karzai was firm in his belief that the Quetta Shura Taliban must come to the negotiating table as one part of the Afghan political society, not as a separate entity. The Taliban, on their part, were also not prepared to hold bilateral discussions with Kabul, insisting on the presence of the Americans at the negotiating table. They often called Karzai a "lackey of the Americans" – a person who is not free to decide Afghanistan's future without American participation.

Some Pakistani analysts, including those with a deep knowledge of Afghan-Pakistan affairs, were of the view that in approaching the Afghan President, Islamabad should make clear that Pakistan had already paid a very heavy price living next to a highly troubled neighbour. Najamuddin Shaikh, Pakistan's former Foreign Secretary, wrote an op-ed article for *Dawn* that appeared while Karzai was still in Pakistan. He suggested that the Afghan leader should be reminded that Pakistan "provided shelter to some five million Afghans but which is nevertheless painted as the principal villain. Afghanistan has just cause for complaint but Karzai needs to acknowledge the contribution that Afghanistan and its leadership have made towards creating this situation...This does not seem to resonate in Kabul. This then is the background against which the Karzai visit is to be viewed".<sup>5</sup> The presence of such a large number of Afghans in Pakistan is discussed in a later section.

Karzai travelled to Pakistan believing – and saying as much in several statements he gave before heading for Islamabad – that Mullah Omar and his Quetta Shura were under the influence of the ISI, Pakistan's premier intelligence service. Islamabad was not prepared to accept that the Pakistani military in general, and the ISI in particular, had influence, let alone control, over the Afghan Taliban. This was the case even if their activities were largely guided and administered from Quetta in Pakistan. That said, it was of some significance that General Ashfaq Kayani, Chief of Staff of the Pakistani Army (COAS), and Lt General Zaheer ul-Islam, the Director General of ISI, participated in the discussions with Karzai and his team. Their involvement was a clear indication that Sharif did not appear to have a totally free hand in the shaping of his Afghan policy. As the newspaper *Dawn* noted in an editorial, it is "interesting to note that,

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<sup>5</sup> *Ibid.*

however, the Sharif government is still allowing such a visible and public role to the military high command”, in the formulation and conduct of its foreign policy. Karzai’s team did not include army and intelligence officials.<sup>6</sup> Even if he had wished to help Karzai over the Taliban issue, it was not what the Pakistani military wanted him to do. As noted below, he had greater freedom of movement in the economic field.

The press in both countries underscored the Afghan leader’s disappointment with the Islamabad/Murree talks. According to a headline in *Dawn*, Pakistan’s premier English language newspaper, Karzai went back to Kabul “disappointed”.<sup>7</sup> The same sentiment was reflected in a story in the Afghan daily, *Hasht-e-Subh*. The statement issued by the Afghan presidency after Karzai’s return to Kabul said that “the Pakistani side is expected to take specific and practical steps in accordance with the decisions made during the negotiations”. The suggestion in the statement was that something was accomplished; but what Islamabad promised was not made clear. The Pakistani Foreign Office also gave its own version of the outcome. Both sides had “reaffirmed their commitment to deepen and broaden” their bilateral relations and “agreed to work together for the promotion of peace and reconciliation” in Afghanistan. The Pakistani statement did not mention the Taliban by name.

## **American Withdrawal from Afghanistan**

The US plans to pull out its troops from Afghanistan by the end of 2014 will have enormous political and economic consequences for both Afghanistan and Pakistan. If the American withdrawal leads to political upheaval in Afghanistan, similar to the one that followed the Soviet pull-out in 1989, there will be serious political and security implications of that for Pakistan. The fear that this might happen causes enormous anxiety in Pakistan, one reason why the new government wants to see some accommodation between Kabul’s current and future leaders and the Taliban. At the same time, Islamabad is anxious that the American withdrawal should not increase the influence of India in Afghanistan. This is the main reason why Islamabad has not been prepared to move against the Haqqani group which had been closely aligned with the ISI ever since the war against the Soviet occupation. The Haqqanis, an Afghan group that had created a sanctuary for itself in Pakistan’s North Waziristan, has been loosely aligned with the Quetta-Shura Taliban. Its operations have been conducted entirely against foreign troops in Afghanistan. Unlike the South Waziristan-based Tehrik-e-Taliban which has targeted the Pakistani state, the Haqqanis have shown no hostility towards Pakistan. The Pakistani military has not been inclined to end this equilibrium. But the Americans as well as the government in

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<sup>6</sup> *Dawn* editorial, “Unresolved issues: Afghan president’s visit”, 28 August 2013, p. 7.

<sup>7</sup> Baqir Sajjad Syed, “Afghan leader returns disappointed”, *Dawn*, 28 August 2013, 2013, p. 1.

Kabul have been urging Pakistan to move against the Haqqanis. Pakistan has wanted to leave them alone, counting on their help in the post-2014 Afghanistan.

In the area of economics, the American withdrawal will hurt Afghanistan enormously. The data in Table 1 below provides some indication of how dependent is the country on foreign assistance, most of which comes from the United States. For instance, without foreign grants the current account deficit in 2012-13 was almost 45 per cent of GDP. Including grants, the current account turns positive – nearly four per cent of GDP. It is clear that without foreign help, the Kabul government will not be able to sustain the current level of imports. This will have consequences for Pakistan. As discussed later, without aid, Kabul will not have the resources to pay for the large trade deficit it has with Pakistan.

That said, there may be some short-term benefits for Pakistan because of the enormity of the withdrawal operation and the compensation Pakistan is likely to receive for allowing its territory to be used by the American forces for their withdrawal. The newsmagazine, *The Economist*, has provided some estimates of what the American withdrawal is likely to involve. “In the next 18 months America expects to remove as many as 28,000 vehicles and 40,000 shipping containers of equipment. In military jargon, the whole action is ‘the retrograde’. Shifting that much kit, with an estimated value of \$30 billion, is daunting enough. The retrograde will itself cost as much as \$6 billion and involve about 29,000 personnel for the American part alone (each of the 50 coalition countries is responsible for its own logistics). The job is unprecedented in complexity...the region’s terrain and politics make it a mover’s nightmare”.<sup>8</sup>

But the cost and complexity of the operation is not the only problem the Americans are likely to face. As William Dalrymple reminded his readers in his latest book, *Return of a King* which tells the story of the 1842 pull out by the British, the last time such a large withdrawal was carried out the result “was one of the great imperial disasters”.<sup>9</sup>

The militants on both sides of the Afghan-Pakistan border will do their best to harass the Americans as they head for the exit, moving their equipment through the two mountain passes through which Pakistan’s road system connects with that of Afghanistan. The Khyber Pass is one the gateways to Afghanistan from Pakistan. The Americans got a foretaste of this on 2 September when, according to the Associated Press, “militants attacked a U.S. base in Afghanistan near the border with Pakistan setting off bombs, torching vehicles, and shutting down a key road use by NATO supply trucks. All three people – apparently all attacking insurgents – were killed. The Taliban claimed responsibility for this in the Torkham area, the latest in a surge of attacks in Afghanistan as US-led foreign troops reduce their presence, en route to a full withdrawal by the end of the year”.<sup>10</sup> The 2014 withdrawal will not be quite like

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<sup>8</sup> *The Economist*, “Withdrawal from Afghanistan: The big retrograde”, 27 April, 2013, p. 34.

<sup>9</sup> William Dalrymple, “*Return of a King: The Battle for Afghanistan*”, New York, Knopf, 2013, p. 76.

<sup>10</sup> *The New York Times*, “Taliban attack U.S. base in Afghanistan”, 2 September, 2013, p. A13.

the 1842 pull-out but it will create serious problems for all the parties involved – the United States, Afghanistan and Pakistan.

## **Unsettled Politics in Afghanistan**

A question for Pakistan's new prime minister, that will remain unanswered for at least a year, is who will take over the reins of power once Karzai, who has dominated Afghan politics for more than a decade, leaves the political stage – if he leaves at all. A few days after his return from Islamabad, Karzai recalled Umar Daudzai, Afghan Ambassador to Pakistan, and appointed him as Minister of Interior. He was the man Pakistan had helped to meet the imprisoned Taliban leader Mullah Baradar. Daudzai was already the favourite to succeed Karzai after the elections, scheduled for April 2014. Since he knows Pakistan well and has had good contacts with Pakistan's senior leadership, it would help Islamabad if he were to take over from Karzai. By placing him in the cabinet now, Karzai took him out of contention. According to the Afghan law, the process of nominating candidates for the electoral fight must be completed by October 2013. According to one newspaper account, the Daudzai "move bolstered speculation about who would, in fact, receive Mr. Karzai's blessing".

Western diplomats and some Afghan officials said that Foreign Minister Zalmay Rassoul now appeared to be the front runner, and some said that they expected an announcement from him soon. If Rassoul does become the next president, it is clear that Karzai will pull strings from behind the stage. Rassoul's "main qualifications were that he is the weakest and least offensive candidate".<sup>11</sup> Faced with such political uncertainty across the border, it seemed right for Pakistan's Sharif to focus his attention on improving economic contacts with Afghanistan. How the Sharif government will seek to achieve that goal is the subject of a later section.

Even after the 2014 elections are over and a person to succeed Karzai has been chosen, the state of politics in the country will remain turbulent. With the American umbrella that provided considerable political cover to the Karzai regime lifted, the successor government will be on its own. It will have to contend not only with the increasing level of insurgency but will also need to settle the many ethnic divides that have bedevilled Afghan politics for centuries. The most consequential of these is the accommodation of the Pakhtuns in the emerging political system. This is the largest ethnic group in the country, accounting for two-fifths of the country's population. This group was mostly sidelined during the ten-year rule by Karzai who relied on the non-Pakhtun groups such as the Tajiks and the Uzbeks in the country's northeast for support. These are the groups that had helped the United States to overthrow the Taliban government in

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<sup>11</sup> Rod Nordland, "Karzai appointment sidelines possible candidate", *The New York Times*, 1 September, 2013, p. A11.

December 2001. Their reward was a disproportionate amount of power in the political structure created after the fall of the Taliban. This cannot be a stable system in the post-2014 and post-America era in Afghanistan.

Compounding the problem for Afghanistan's future political system is the way some of the regional powers have aligned themselves with the various ethnic groups in the country. Pakistan, with about 25 million Pakhtuns in its population of 190 million, is understandably involved in Pakhtun affairs across the border in Afghanistan. India has always had good relations with the minority communities in the northeast. Iran supports the country's Shia population. Unless the regional powers work together to bring peace to this long-troubled country, its political evolution will become even more complicated.

## **The Afghan Economy**

Whether peace will return to the country that has been at war for three and a half decades remains an open question. It is only with political stability that the country can hope to recover what it has lost in terms of economic development. The rates of GDP growth have been high in recent years; the economy grew by 21 per cent in 2008-09, slowing down to 8.4 per cent in the following year, and further slowing down in 2011-12. The World Bank expects the rate of growth to have picked up to 11.8 per cent in 2012-13. However, these impressive rates are not sustainable. They represent some recovery from the devastation caused by the prolonged war and the copious external assistance that flowed after the Americans moved into the country in December 2001. Donor grants have ranged between 10 and 16 per cent of national income. These will decline significantly after the American and NATO troops leave by December 2014. (See Table 1 for the data on the performance of the Afghan economy.)

In spite of the rapid GDP growth of recent years, the economy's output is still below that reached in the late 1970s when the Soviet Union invaded the country. In 2012-13, nominal GDP (excluding opium) was estimated at US\$ 19.8 billion which, for a population of 33.4 million, works out to only US\$ 595 per capita. While exports brought in US\$ 2.61 billion into the country, as much as US\$ 11.17 billion were spent in buying imports. This left a trade imbalance of about US\$ 8.6 billion, or approximately 43.1 per cent of GDP. This was financed by the donors, mostly the United States. As shown in Table 3, in 2010-11, the trade deficit with Pakistan alone amounted to almost US\$ 2.2 billion, or almost 26 per cent of the total. With a squeeze on the flow of foreign assistance into the country after the departure from the country of United States and its allies, this will adversely affect the Afghan-Pakistan trade.



**Table 1: Afghanistan's Economic Performance**

	2007/8	2008/9	2009/10	2010/11	2011/12	2012/13
Nominal GDP (\$ billion)	9.8	10.2	12.5	15.9	18.0	19.8
Population (million)	29.1	29.8	30.6	31.4	32.4	33.4
GDP per capita (\$)	338	342	408	507	557	595
Exports (\$ billion)	1.85	2.46	2.52	2.64	2.75	2.61
Imports (\$ billion)	7.39	8.95	9.47	9.95	10.62	11.17
Current account balance (excluding grants)	-60.6	-66.0	-58.6	-48.5	-45.9	-44.9
Current account balance (including grants)	5.2	5.3	1.6	2.8	2.2	3.9
Trade balance	-56.3	-63.6	-55.6	-45.9	-43.6	-43.1
Trade balance (\$ billion)	-5.54	-6.49	-6.95	-7.31	-7.87	-8.56

*Source: The World Bank, Afghanistan Economic Update, April 2013, p. 24*

Even when opium is excluded from the picture, the economy remains mostly agricultural and pastoral. In 2012, agriculture contributed 33.2 per cent to GDP, a slight decline compared to its contribution (31.8 per cent) in 2005. The share of manufacturing, which is mostly small scale, declined from 16.9 per cent to 14.1 per cent while that of services increased from 40.9 per cent to 46.4 per cent. Construction – a relatively big sector, given the need for reconstruction from the extensive damage caused by war – contributed considerably more to national income than is normal for a country at Afghanistan's stage of development. However, its share declined from 10

to 7.5 per cent. The share of mining – a sector with considerable potential – increased from 0.3 to 1.8 per cent, a six-fold expansion.<sup>12</sup>

For the future, Afghanistan will have to rely more on its own resources than on foreign help. This will entail rebuilding the sectors of agriculture, having local and foreign entrepreneurs invest in small and medium enterprises, and inviting foreign mining companies to exploit the country's mineral wealth. Pakistan can help in each of these three areas. It has the expertise in the first two, and its cooperation will be needed in the third.

Sharif and his team have focused much more on economic issues and cooperation in that area than on helping the Afghans reach an understanding with the Taliban. This stance is in keeping with the new Pakistani Prime Minister's overall approach to foreign affairs. He is of the view that difficult inter-country problems could be resolved more easily once strong economic ties have been established. He is using the same approach in reaching out to India. In this context, it is of some significance that Karzai was not the first foreign head of the state or government to visit Islamabad after Sharif became Prime Minister. That honour was given to Prime Minister Yingluck Shinawatra of Thailand with whom Sharif had a detailed discussion on how to improve economic relations with a country that he believes is an important member of the Association of Southeast Asian Nations. So far Sharif seems not to have decided whether, in bringing Pakistan out of an economic recession that has lasted for six years (the longest in its history), he should look east towards China, India, and Southeast Asia or to the west towards Afghanistan, the Middle East, Europe and North America. Or Pakistan could become a bridge between these two areas of economic activity.

In spite of the difficulties on the political front, Pakistan's Prime Minister is convinced that serious and palpable progress could be made in the field of economics. Although as discussed below, Pakistan had served as the gateway to Afghanistan for years, no effort was made to develop strong economic ties and to link, in any meaningful way, the economies of the two countries. Most contacts were of informal nature. Before the Soviet Union's invasion of Afghanistan in 1979 that made passage between the two nations difficult and hazardous, tens of thousands of Afghan nomads used to spend winter, with their animals, in the plains of north Pakistan. Called the "pawanidas", they moved in and out of the two countries without being constrained. While the Soviet occupation put an end to this free flow of people, it generated another kind of human movement. Millions of refugees moved from Afghanistan to Pakistan to escape the harsh environment created by the Soviet Union's occupation. While most of these internally displaced people, in the language of the United Nations, were accommodated in dozens of temporary camps along Pakistan's long border with Afghanistan, tens of thousands went and settled in several large cities.

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<sup>12</sup> These data are from The World Bank, *Afghanistan Economic Update*, April 2013.

## The Afghans in Pakistan

In spite of the repatriation of an estimated 3.8 million registered refugees back to Afghanistan, the United Nations High Commission for Refugees, the UNHCR, has estimated that Pakistan still “hosts over 1.6 million registered Afghans, the largest and most protracted refugee population in the world”. The UN agency has continued to remain active in Pakistan, moving into the phase of creating a more secure environment for the Afghan people who remained out of their country. It called its approach the “Solutions Strategy” to distinguish it from the provision of relief which was its main preoccupation. The agency remains concerned with the security situation in Pakistan. “The overall security situation remains fragile, and State operations to restore law and order in 2013 are expected to result in new displacements. Despite the Government’s commitment to the Solutions Strategy for Afghan Refugees endorsed by all concerned stake holders, in Geneva in May 2012, there is as yet no national legal framework for asylum in Pakistan. UNHCR will continue to advocate to Pakistan accession to the Refugee Convention and the drafting of a refugee law”.<sup>13</sup>

**Table 2: Displaced People in Pakistan**

	December 2012	January 2013
Type & population		
From Afghanistan	1,555,630	1,649,630
Other countries	750	750
Internally displaced	700,000	745,000
Returnees	100,000	100,000
Total	2,359,880	2,497,880

*Source: UNHCR country operations profile: Pakistan, July 2013*

The economic, social, and political impact of this large movement of people – the largest since the arrival of eight million refugees from India in 1947 – is still not fully studied and understood but is profound. This is particularly the case with the influx of the Afghan displaced people in the violence prone mega-city of Karachi.<sup>14</sup> The Afghans in Pakistan have also come to dominate some of the economic activities in their adopted homeland. They have become active in the trucking industry, playing a significant role in transporting the supplies from the port city of

<sup>13</sup> UNHCR, The UN Refugee Agency, “2013 UNHCR Country Operations Profile: Pakistan”, July 2013.

<sup>14</sup> For the impact of the arrival of Afghans on the unsettled conditions in Karachi, see Shahid Javed Burki, *Exploding Karachi*, ISAS Brief No. 212, 15 August 2011. [http://www.isas.nus.edu.sg/Attachments/PublisherAttachment/ISAS\\_Brief\\_212\\_-\\_Email\\_-\\_Exploding\\_Karachi\\_22082011094422.pdf](http://www.isas.nus.edu.sg/Attachments/PublisherAttachment/ISAS_Brief_212_-_Email_-_Exploding_Karachi_22082011094422.pdf)

Karachi to the American and NATO troops fighting in Afghanistan. They also entered small-scale mining, especially in exploiting the deposits of precious and semi-precious stones in many border areas between Afghanistan and Pakistan. With the increase in attention paid by Islamabad and Kabul in building strong economic ties, a more productive deployment of the Afghan population in Pakistan should become possible. The human resource is not the only one the two nations could use for mutual economic benefit.

## **Working Together in the Economic Field**

Ever alert to Pakistan's economic potential and the public policy to realise it, Sharif is focused on what his country can achieve by working closely with Afghanistan. There is enormous amount of untapped mineral wealth – including energy – to be found below the ground in both countries, some of it in the areas that stretch across the border. In 2011, it was reported in the American press that the Pentagon had estimated Afghanistan's mineral wealth at \$1 trillion, some of it in the areas adjacent to the border with Pakistan.<sup>15</sup> Mineral veins do not stop at political borders. Several stretch across Afghanistan and Pakistan. Afghanistan has in the ground impressive deposits of iron, copper, and rare metals. So, it seems, does Pakistan. On the day Karzai was in Islamabad, it was reported that the Energy Information Agency had come out with an impressive 'read' on Pakistan's energy endowment. It estimated that Pakistan, in the areas adjacent to Afghanistan, had shale gas reserves of 105b trillion cubic feet (TCF) and more than nine billion barrels of oil.<sup>16</sup> The new Pakistani Prime Minister believes that his country and Afghanistan should work together to exploit their enormous mineral wealth. This could perhaps be done with China's assistance, a matter raised during Sharif's visit to China that began in July 2013. If the plan to develop the China-Pakistan Economic Corridor materialises, it could provide the infrastructure that would be required to exploit the mineral deposits in both countries.<sup>17</sup>

The second Karzai-Sharif meeting, at Murree, was preceded by a detailed discussion between the finance ministers from the two sides. The statement issued following that meeting was more detailed in substance than the short Karzai-Sharif press conference on 27 August. The finance ministers announced a number of concrete steps. Pakistan will help build the second carriage-way linking Torkham (a town on the Pakistani side of the border) with Jalalabad, the largest city in eastern Afghanistan. That would extend Pakistan's motorway system from Lahore to well within Afghanistan. This would facilitate not only trade between Afghanistan and Pakistan but also between India and Afghanistan. The latter, of course, would depend on Islamabad's

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<sup>15</sup> James Risen, "US identifies vast mineral riches in Afghanistan", *The New York Times*, 13 June, 2011, p. A1.

<sup>16</sup> Khaleeq Kiani, "Pakistan said to have large reserves of shale gas and oil", *Dawn*, 28 August, 2013, p. 1.

<sup>17</sup> Shahid Javed Burki, *China's 'Look-West' Policy; A New Link with Pakistan*, ISAS Brief No. 293, 20 August 2013. [http://www.isas.nus.edu.sg/Attachments/PublisherAttachment/ISAS\\_Brief\\_No\\_\\_293\\_-\\_China's\\_'Look-West'\\_Policy\\_\\_A\\_New\\_Link\\_with\\_Pakistan\\_20082013172936.pdf](http://www.isas.nus.edu.sg/Attachments/PublisherAttachment/ISAS_Brief_No__293_-_China's_'Look-West'_Policy__A_New_Link_with_Pakistan_20082013172936.pdf)

willingness to open its space for India's commercial traffic to Afghanistan and the countries beyond in Central Asia.

The Pakistani side also committed itself to the full implementation of the Transit Trade Agreement (TTA) between the two countries. Signed on 28 October 2010 under considerable American pressure, the new treaty included Lahore as the point of exit – but not of entry – for the goods and commodities exported by Afghanistan. This was a partial step towards the use of Pakistani territory for facilitating trade between India and Afghanistan. The 2010 TTA allowed the passage of Afghan goods and commodities to India, but not those from India to Afghanistan. The TTA has been negotiated several times since 1950 when the first version was signed. This treaty and its subsequent incarnations essentially opened the port of Karachi to landlocked Afghanistan.

**Table 3: Pakistan-Afghanistan Trade (US\$ Million)**

	Pakistani exports	Pakistani imports	Total trade	Balance
2000-01	140	29.5	170	110.9
2001-02	169.2	22.9	192.1	146.4
2002-03	315.7	34.8	350.5	280.8
2003-04	492.9	47.4	540.3	445.4
2004-05	747.7	38.9	786.7	708.7
2005-06	1063.4	47.5	1110.9	1015.9
2006-07	753.9	76.2	830.2	677.6
2007-08	1143.6	91.3	1235	1052.3
2008-09	1398	93	1491	1305
2009-10	1572	139	1711	1433
2010-11	2336.7	172	2508.7	2164.7

*Source: Pildat, Pak-Afghan trade, Islamabad, December 2011*

As shown in Table 3, Pakistani exports to Afghanistan have increased almost 17-fold since the fall of the Taliban regime and the arrival of the Americans and its allies in that country. There was some increase in Pakistan's imports, but not by as much as the growth in exports. This left Pakistan with a large trade surplus in its favour. Some of the Pakistani exports were the result of the presence of large foreign forces in Afghanistan, some of whose needs could be met by Pakistani suppliers. Some were the result of increased construction activity which grew as the Americans made significant investments in rebuilding the war-torn country. These exports will be seriously affected as the Americans pull out. And as already indicated, Kabul will not have the resources to finance such a large trade deficit with Pakistan.

As a businessman, Sharif knows that the old and new trade transit arrangements are not always popular with the some members of the business community. The series of treaties allowed Kabul to import goods free of Pakistani tariffs as long as they were not off-loaded in Pakistan. But there were serious leakages as the treaties opened opportunities to the Pakistani traders and smugglers to bring in banned goods or those that faced a high wall of tariff in Pakistan. The arrangements were resented, in particular, by the Pakistani manufacturers who saw the smugglers' ability to breach the high wall of tariff as a major problem for their businesses. Large scale smuggling hurts domestic manufacturers when an economy is closed with a high wall of tariff and other restrictions on international commerce that protect the domestic industry from international competition. Illegal entry of foreign manufactures reduces the protection many local businesses enjoy. That was the case in Pakistan at the time the first Sharif government (1990-93) took office. The then Finance Minister Sartaj Aziz presided over the preparation of a reform programme that lowered trade tariffs, encouraged foreign capital flows, and invited private foreign investment. Aziz is now an advisor to the prime minister and has a palpable influence over the making of public policy, in particular, foreign policy. He sees the benefits a good working relationship with Afghanistan would bring to his country. Easing of trade restrictions is an important part of this strategy. For instance, allowing India access through Pakistan to Afghanistan and beyond will be not only good politics but also good economics. As a part of the overall economic opening to India which Sharif is keen to undertake, the 2010 TTA could be modified to allow two-way trade between Afghanistan and India. This would bring enormous benefits not only to those two countries but also to Pakistan.<sup>18</sup> Islamabad could charge a significant transit fee for the use of its territory for this purpose of trade.<sup>19</sup>

The Pakistani and Afghan governments have also agreed to collaborate on the issue of water, in particular, the sharing of this precious and highly-stressed resource. Pakistan and Afghanistan share nine rivers, with annual flows of 18.3 million acre feet with the bulk (16.5 MAF) accounted for by the Kabul River. It joins the Indus at the town of Attock on the border between the Pakistani provinces of Punjab and Khyber-Pakhtunkhwa. The Kabul River system is an interesting waterway since one of its major tributaries, the Kunar River originates in Pakistan. There, called the Chitral River, it flows into the Kabul and re-enters Pakistan. The Kabul River, therefore, has Pakistan both as an upper and lower riparian state. This system of rivers was once navigable. The valleys through which they flow were the easiest way to travel from the Pamir mountain passes in western China to the plains of what is now Pakistan. The development of the long Kabul River valley could add another link of commerce between China and South Asia.

Pakistan and Afghanistan have agreed to set up a joint commission on the development of the Kabul River for exploiting it and its fast-flowing tributaries for generating electricity. At the

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<sup>18</sup> For a discussion of this aspect of India-Pakistan relations, see Shahid Javed Burki, *“South Asia in the New World Order: The Role of Regional Cooperation”*, London, Routledge Contemporary South Asian Series, 2011.

<sup>19</sup> See Aparna Pande, *“Explaining Pakistan’s Foreign Policy: Escaping India”*, London Routledge 2011, p. 82

meeting in Islamabad on 25 August, a day before Karzai landed in the Pakistani capital, an agreement between Islamabad and Kabul was reached between Ishaq Dar and Hazrat Omer Zakhilwel, the two finance ministers, to create institutional mechanisms for economic cooperation. The two governments agreed to give priority to the construction of a hydroelectricity plant for generating 1,500 MW. The project will be designed, constructed and managed by a new entity called the Kabul River Basin Management Commission. The KRBMC will be modelled after the Indus Waters Commission that was created after the signing of the Indus Water Treaty by India and Pakistan in 1960. Some preparatory work has been done by the World Bank which is encouraging Pakistan and Afghanistan to develop this resource. It has already spent \$12 million studying the project.<sup>20</sup>

In order to ensure that the decisions taken in Islamabad by the two economic teams would be implemented, Afghanistan and Pakistan have agreed to hold a meeting in October under the Joint Economic Commission. The JEC will meet in Kabul. It is Pakistan's hope that enough momentum will be built up fairly quickly to overcome some of the inevitable hiccups on the political front.

## Conclusion

There are some fundamental differences between the policy priorities of the leaders who are currently in power in Kabul and Islamabad. Karzai is more concerned with the immediate while Sharif is more focused on the long-term. The Afghan president's second term is approaching its end; the constitution does not permit him a third-term. The Pakistani Prime Minister has just begun his third term in office and has less than five years to go. Karzai wants to bring peace to his country without surrendering it to the Taliban. Sharif is more interested in reviving the stalled economy of his country. With such differences in the goals to be reached and policies to be followed, can the two sides relate to each other? Will the attempts to realise economic opportunities triumph over the need to deal with political exigencies? Will the likely American withdrawal from Afghanistan create difficulties for both Afghanistan and Pakistan? Will the regional powers – Pakistan, India and Iran – use Afghanistan as a competing ground or will they cast off the burdens of a troubled history and work together to bring peace to this long-troubled land? Only time will provide answers to these important questions.

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<sup>20</sup> Khaleeq Kiani, "Pakistan, Afghanistan mull over power project on Kunar River", Dawn, 26 August, 2013, pp. 1 and 3.