

ISAS Working Paper

No. 188 – 15 May 2014

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Pakistan's New Choices in Economic Diplomacy

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Introduction

For the last several decades Pakistan has based its foreign economic relations on bilateral contacts. Both the fears and rewards were based on the policy making equations involving two variables: Pakistan and another country. Thus Pakistan-India, Pakistan-China, Pakistan-Great Britain, Pakistan-Saudi Arabia and, to a lesser extent Pakistan-Iran, dominated Islamabad's

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foreign affairs. This approach will need to be updated in view of the rapid developments taking place in the global economic and political orders. A number of changes have already brought into play new actors for Pakistan to reckon with. In the reshaped – and reshaping world – bilateralism may lose significance to ‘multi-nationalism’. I use the term, multi-nationalism, rather than multilateralism since the latter generally refers to institutions such as the United Nations and its constituent agencies as well as the institutions such as the International Monetary Fund, the World Bank, and the several regional development banks.

The new Pakistani Government headed by Prime Minister Mian Nawaz Sharif, that took office on 5 June 2013 after a decisive win in the elections of 11 May 2013, is in the process of developing a new foreign policy orientation. This is likely to move the country away from the concerns and fears that guided it in the past and towards an approach that places greater emphasis on economic rewards. The assumption is that while Pakistan makes this important transition, it will not be distracted by developments over which Islamabad has no control. That may not be a valid assumption on which to base the needed rethink on external affairs.

The past process was ‘India-centric’ in the sense that Pakistan tried, sometimes with desperation, to balance India’s growing military might. That approach proved costly. In a 2007 report, I wrote for the United States Institute of Peace, in which I estimated the cost to Pakistan of the running dispute with India over Kashmir and other issues. I estimated that the Kashmir dispute alone had cost Pakistan 2.25 per cent to 3.2 per cent a year of growth loss in GDP terms. Compounded over a period of six decades, this suggests the magnitude of the colossal damage Pakistan has done to its economy by following this particular quarrel with India.² This study used purely economic factors; it did not take into account the undeniable fact that some of the cost of this approach towards India contributed to the rise of Islamic extremism in the country. That, too, has resulted in serious economic losses.

I will argue here that Islamabad should factor in multi-nationalism in the making of public policy. It should look in particular at the development of two ‘quadrilateral’ arrangements right on its borders. The focus is on maximising economic returns for Pakistan from the relationships

² Shahid Javed Burki, *Kashmir: A Problem in Search of a Solution*, United States Institute of Peace, Washington DC, 2007, Table 10, p 25.

it should cultivate in the context of the development of essentially informal multi-national groupings.

That said, the pursuit of bilateralism as an approach in external affairs continued in the first few months of the new regime in Islamabad. Restoration of a balance of sorts with the United States (US) received a lot of attention. It was motivated largely by the need to obtain immediate relief for the unsustainable pressure on external accounts. America could help – and it did – by releasing money from the Coalition Support Fund, the arrangement established for compensating Pakistan for the use of its road network for supplying the American and NATO (North Atlantic Treaty Organisation) troops operating in Afghanistan. Islamabad also pressed Washington to make available the financial resources promised under the Kerry-Lugar Act for priority sectors and projects. This Act was signed into law by the newly-elected President Barack Obama in October 2009. It promised a continuous flow of America assistance into Pakistan at the annual rate of US\$ 1.5 billion over a period of five years with the expectation that the period of financial support could be extended beyond 2014. Saudi Arabia was approached – again with success – to provide US\$ 1.5 billion contribution to the resurrected Pakistan Development Fund. The Fund was established by the Asif Ali Zardari Government in 2009 in the expectation that the West would support Pakistan as it finally began to move towards the creation of democratic political order. China is working with Pakistan on a number of multi-billion infrastructure projects. These include several large dams on the Indus River, called the ‘Indus Cascade’ programme by the World Bank. China will also provide financial support and technical advice for the development of this project as well as the China-Pakistan Economic Corridor. Large amounts of Beijing’s input have been talked about. Prime Minister Sharif has reached out to New Delhi to put relations with India in economic terms. There is no longer talk in Islamabad about India posing an existential threat to Pakistan. It is expected in Islamabad that once India elects a new Lok Sabha, the lower house of Indian Parliament, in May 2014 and installs a new government in New Delhi, the pace of improvement in relations may pick up.

However, by focusing on bilateralism policy makers in Pakistan may be losing sight of the fact that in a rapidly reordering world what may matter more is multi-nationalism. The obvious examples of this are the two quadrilateral relations taking shape around Pakistan’s borders. The first of these involve the US, Russia, Western Europe and China; the second the US, China,

Japan and India. The form that these relationships take will have enormous consequences for Pakistan. I will deal in turn with both of them.

The First Quadrilateral: US, Russia, Western Europe and China

The first quadrilateral came into being in rather unexpected ways. It got created by the unexpected move by Russia aimed at consolidating its hold on what was left of the eastern part of what was once the extensive Soviet empire. Russia, in other words, is the central player in this informal grouping. Its actions will give it shape. But the consequences of this development will go beyond Europe; it will impact large parts of the Asian continent.

In economic terms, Russia has not mattered much for Pakistan in the past. If it did, it was used by the policy makers in Pakistan to draw closer to Washington during the Cold War years.³ The only significant economic contribution Moscow made was to help Pakistan build a steel mill near Karachi. The mill has proved to be more of an economic liability than an asset. Its yearly losses are a significant drain on the federal budget. Russia is not a very significant trading partner, either, for Pakistan. As shown in Table 1, Pakistan's total trade with Russia was estimated at only US\$ 343 million in 2012-13. However, the political aspects of this relationship may change as Russia, under President Vladimir Putin, begins to assert itself not as a European and westernising power as the West had hoped but as a large country with global ambitions. As Anne Applebaum wrote for *The Washington Post*, 'openly or subconsciously, since 1991, Western leaders have acted on the assumption that Russia is a flawed Western country. Perhaps during the Soviet years it had become different, even deformed. But sooner or later, the land of Tolstoy and Dostoevsky, the home of classical ballet, would join what Mikhail Gorbachev, the last Soviet leader, so movingly called our "common European home"'.⁴

³ This is the main theme of the 2013 book by Hussain Haqqani, Pakistan's Ambassador to Washington during most of the period when President Asif Ali Zardari was effectively in charge of policy making in Islamabad. See his *Magnificent Delusions: Pakistan, the United States and an Epic History of Misunderstanding*, New York, Public Affairs, 2013.

⁴ Anne Applebaum, "Russia unveiled", *The Washington Post*, 21 March 2014, p. A19.

Table 1: Pakistan's Trade Balance with Selected Countries, 2012-13			
(US\$ Million)			
Country	Exports	Imports	Trade Balance (+ Surplus/ - Deficit)
Afghanistan	1,059	45	1,014
Bangladesh	680	59	621
China	2,699	4,726	-2,027
India	329	1,677	-1,348
Iran	94	22	72
Japan	188	1,431	-1,243
Russia	235	108	127
Saudi Arabia	512	3,963	-3,451
United States	3,887	1,018	2,869
Sum of Above	9,683	13,049	-3,366
As % of Global Pakistani	39.0	32.5	
Source: Economic Data, State Bank of Pakistan.			

That movement has been put on hold by the exercise of what Western scholars and policy analysts have begun to call 'Putinism'. Michael A McFaul, a Stanford-based scholar specialising in Russian history who served the United States as Ambassador in Moscow, noted the tensions that mark the current Moscow approach towards the world that resulted from the country's efforts to reform itself and become a part of the Western society. 'Some Russians pushed forward on this enormous agenda of revolutionary change', he wrote in a recent newspaper article. 'And they produced results: the relatively peaceful (so far) collapse of the Soviet empire, a Russian society richer than ever before, greater protection of individual rights and episodic functioning democratic institutions. But the simultaneity of democracy's introduction, economic depression and imperial loss generated a counter-revolutionary backlash – a yearning for the old

order and resentment of the terms of the Cold War'.⁵ That is now what is unfolding in Russia's relations with the world.

As the events involving Ukraine made abundantly clear, President Putin has a different vision for Russia's future. His ambitions have already resulted in redrawing the map of Europe by the quick assimilation of the Crimean peninsula into the large Russian geographic space. The Russians interpreted their move as throwing off the cloak of defeat in the Cold War. 'For 23 years after 1991, Russia has been treated consciously or subconsciously as defeated in the Cold War', said Dmitry Kosyrev, a writer and political commentator with the RIA Novosti news agency in Moscow. 'Russia has not accepted this mentality. We have something to say. We have not only interest but experience. We are not defeated country in the Cold War; we are something separate like India and China'.⁶ On the sidelines of a large meeting held to discuss nuclear security issues in the Netherlands, the G7 nations (the US, Canada, Japan, France, Germany, Great Britain, and Italy) decided to exclude Russia from the club it was invited to join in 1998, seven years after the collapse of the Soviet Union. The Russians had sought a seat at the table after the collapse of the Soviet Union and it took seven years before the G7 was prepared to convert itself into G8. In 2014, Russia was to be the host of the summit. This would have been the second time that Russia would have acted as the host, this time at Sochi, the site built under the personal supervision of President Putin at a great cost for the 2014 Winter Olympics. With Russia thrown out, the G7 agreed to go ahead and hold their meeting in Brussels, the capital of the European Union. According to one analyst, 'Mr. Putin took membership in the group so seriously that he went all out when it came time for Russia to host the annual meeting for the first time. He rebuilt a broken-down czarist-era palace outside his hometown, St. Petersburg, in part with the summit in mind, adding a series of new mansions to the grounds for each leader to stay in. The Kremlin hired a Western public relations agency to promote its status as host'.⁷ The work at Sochi was also done with the 2014 G8 summit in mind. Expelling Russia from the group

⁵ Michael A. McFaulk "Confronting Putin's Russia", *The New York Times*, 24 March 2014, p. A19.

⁶ Quoted in David M. Herszenhorn, "In Crimea, Russia Moved to Throw Off the Cloak of Defeat", *The New York Times*, 25 March 2014, p. A9. ,

⁷ Alison Smale and Michael D. Shear, "U.S. and Allies Put Russia Out of Group of 8", *The New York Times*, 25 March 2014, pp. A1 and A8.

created an even greater distance between Moscow and the West, leaving the former to act on its own and achieve its own goals in the areas of the world in which it has abiding interest. That includes Central Asia and within Central Asia, Afghanistan. For Pakistan, the immediate consequence will be the revival of Russian interest in Afghanistan.

The important question for Pakistan is the emerging multi-national aspect of the Russian stance. As the US pulls out of Afghanistan and consequently as the American interest in Central Asia begins to wane, will Russia resume what was once called the Great Game? That game, of course, was played in Afghanistan, the place where two empires no longer in existence – the British and the Czarist Russia – competed for influence. It was from this perspective that the Russian invasion of Afghanistan in 1979 was viewed by most of the world. In a press statement given following the conclusion of the Nuclear Security Summit in The Hague, President Obama was resigned to Moscow's annexation of Crimea as irreversible. However, he caused further irritation in President Putin's Kremlin circles by calling Russia a regional rather than a global power. He said Russia under Putin was acting out of 'political isolation and economic uncertainty'.⁸ In not granting Putin's Russia the status of a global power, the American President seemed to be listening to such academic voices as those of Anne-Marie Slaughter, who advised the American leadership not to return the world to a two-power competition that marked the Cold War. 'That vision of the world does not reflect present realities', she wrote in an article. 'It would become self-fulfilling prophecy that strengthens autocracy in Russia and increases the likelihood of Russia reverting to what the West considers a rogue state. Other nations that have reason to resent what they see as an imposition of Western values would view Moscow as a leader of an independent coalition of states dedicating to protecting national sovereignty. It will be the world Putin wants. We should not let him have it'.⁹ But Kabul's reaction to the events in Europe seemed to suggest that Slaughter's fears were already being realised.

That the Russians are returning to Afghanistan as America continues its slow pullout is not kept as a secret by Moscow. President Putin's message to Kabul sent on Afghanistan's New Year was the only one formally released by the Government of President Hamid Karzai. 'I am certain that

⁸ Scott Wilson and Will Englund, "Annexation of Crimea difficult to reverse, Obama acknowledges", *The Washington Post*, 26 March 2014, p. A11.

⁹ Anne-Marie Slaughter, "It's not a Cold War, yet", *The Washington Post*, 26 March 2014, p. A19.

friendly ties and cooperation between Russia and Afghanistan in the future will add to the goodness and welfare of our people’, wrote the Russian leader in a letter to the Afghan President. Stepan Anikeev, the spokesman for the Russian Embassy in Kabul, was even more explicit about his country’s intentions. ‘You see Russia’s interest in Afghanistan rising. It’s visible’, he told an American correspondent. ‘We want to enlarge our role in the region. It’s not only for Afghanistan, but for own goals’.¹⁰ Moscow’s aid began to arrive; it started working on rehabilitating 140 Soviet-era projects that were not well maintained after the Soviet withdrawal on 15 February 1989. Moscow was confident that its work will have greater impact than the US\$ 100 billion spent by the US on non-military aid. The revival of Russia’s interest in the countries that were once part of the Soviet empire was not lost on Kabul.

On 23 March 2014, Afghanistan joined Syria and Venezuela as a member of the ‘club of nations’ that publicly backed the Russian annexation of Crimea. A statement issued by the office of President Karzai, citing the ‘free will of the Crimean people’, supported Moscow’s action. ‘We respect the decision the people of Crimea took through a recent referendum that considers Crimea as part of the Russian Federation’. Informed analysts read at least two meanings in Kabul’s posture. ‘With the Americans pulling back, [Afghanistan] is looking for assistance from other quarters, and Russia has been increasingly active in offering development aid’, wrote Matthew Rosenberg for *The New York Times*. ‘Given Russia’s heavy influence on countries along Afghanistan’s border, maintaining a long-term relationship with the Kremlin is seen as essential to Afghan foreign policy’.¹¹

But Rosenberg, writing from Kabul, read another meaning in Kabul’s stance that, from Pakistan’s perspective, was much more sinister. ‘But the Russian insistence that it is righting a historical wrong in retaking Crimea, which was ceded to Ukraine by Soviet authorities in 1954, resonates in Afghanistan. Here many believe that the Pashtuns, the country’s largest ethnic group, were unjustly cut off from their brothers and sisters when Britain laid down a border to separate Afghanistan from imperial possessions in South Asia. Most of the world recognised the

¹⁰ The quotations are from Kevin Sieff, “Russia’s Afghan rebirth”, *The Washington Post*, 22 March 2014, p. A1 and A9.

¹¹ Matthew Rosenberg, “Breaking with the West, Afghan Leader Supports Russia’s Annexation of Crimea”, *The New York Times*, 24 March 2014, p. A8.

frontier known as the Durand Line, as the international border when Pakistan became independent in 1947. But Afghanistan did not, and still lays claim to much of north-western Pakistan'. If Russia encourages the Afghans to follow this line, it will enormously complicate Pakistan's situation. A break with Afghanistan will not only make it difficult for Pakistan to gain control over Islamic extremism that has already cost the country enormous economic and human losses, it will cause other kind of economic losses. Afghanistan is the only country in the immediate neighbourhood with which Pakistan has a large trade surplus, estimated at a bit more than US\$ 1 billion in 2012-13. (See Table 1)

One unintended consequence of the Russian incorporation of Crimea may well be for both Washington and Beijing to rethink their evolving policy towards Afghanistan. Beijing will not like to see Russia creep up on one more side of its long border with that country. The Chinese have become active in exploiting the large mineral reserves that Afghanistan is believed to have. A few years ago, a Pentagon study valued that wealth at US\$ 1 trillion. China was given the right to work on one of the sites that has rich iron deposits. Natural resource-short Beijing will not easily surrender that space to Russia.

At the same time the Western narrative about Russia has already begun the change. To quote Applebaum again, 'Russia is not a flawed Western power. Russia is an anti-Western power with a different, darker vision of global politics'. This recognition gives a new prism through which the West will now be looking at Moscow. It is unlikely that President Obama and his national security team would create an enormous vacuum in Afghanistan, should they opt for what Washington calls the 'zero option' – leaving no troops behind when the Americans complete the withdrawal of their combat troops which they are programmed to do by the end of 2014. The total pullout will be the result of President Karzai's refusal to sign the Bilateral Security Agreement (BSA) his government had negotiated with the US in the fall of 2013 and which was subsequently approved by the grand assembly of Afghan elders, the 'Loya Jirga'. The Afghan President may have dragged his feet expecting that a resurgent Russia would want to play a larger role in his country. In shaping its own policies Islamabad should be mindful about the new and much more complicated game that is about to be played right on its borders.

The Second Quadrilateral: US, China, India and Japan

The other multi-national quadrilateral that has significance for Pakistan involves the US, China, Japan, and India. While the new great game involving the US, Russia and Western Europe is being played with a well-understood historical background – that of the 19th century Great Game – the second quadrilateral is taking shape without a clear understanding of how the three Asian powers involved in it look at history. As Rana Mitter, a professor of Chinese history at Oxford, points out in his recent book, *China's War with Japan*, the West does not fully understand the far-reaching effects on China's outlook and attitudes of its prolonged war with Japan. For Europe, the Second World War began in 1939 when Germany invaded Poland; for the US, it began even later in 1941 with the Japanese attack on Pearl Harbour. For the Chinese the war began much earlier – in 1931 with the Japanese invasion of Manchuria and its subsequent annexation in 1937. The US and the British Empire each suffered losses of 400,000; in China this figure was 14 million, a total exceeded only by the Soviet Union.¹² There are, therefore, historical reasons why China looks at Tokyo with a combination of suspicion and fear. This is especially the case when Japan, in Prime Minister Shinzo Abe, has a leader with strong nationalist leanings. Washington appears to be in favour of Tokyo changing its constitution that forswore expenditure on rebuilding the country's military, much of which was destroyed in the Second World War. The constitution was written by the Americans and is now regarded as out of date. Tokyo is gradually giving up its pacifist approach to foreign affairs and has begun to invest more on defence.

But Japan is not the only worry that Beijing has at this time. Washington and Beijing are wary of each other's intentions in the Pacific as China continues to gain in economic strength and applies it to building its military, in particular the navy. While the evolving US policy towards China is still not called "containment", this is not the way many policy makers in Beijing see it.

One of the many ways in which China will seek to counter the American pressure is to open an access to the Indian Ocean by improving the land corridor that connects its western parts with Pakistan. In July 2013, Pakistan's Sharif signed a memorandum of understanding to build what is called the China-Pakistan Economic Corridor. Making use of the already operational Karakorum

¹² Rana Mitter, *China's War with Japan: 1937-1945: The Struggle for Survival*, London Allen Lane, 2013.

Highway, the corridor will connect the port of Gwadar on Pakistan's Baluchistan coast with the autonomous region of Xinjiang. This can be seen as China's 'look west' policy.¹³ India is the fourth player in this game and there will be enormous consequences for Pakistan in becoming a member of this particular quadrilateral.

There have been dramatic improvements in the post-Cold War era in Washington's relations with New Delhi. The process began during the tenure of President Bill Clinton. It moved rapidly forward when President George W Bush almost recognised India as a member of the restricted nuclear club, something that Pakistan is seeking but is unlikely to get in view of its past involvement in nuclear proliferation. Washington, during the presidency of President Obama, has begun to look at India to provide some balance to the growing presence of China in Asia. The Indians also became more aggressive in looking at China as a threat. Preparing for the just-concluded elections in May 2014, Narendra Modi, the Hindu nationalist from the state of Gujarat in the country's west, travelled across the sub-continental country to speak at a rally in the far north-east. He addressed the people in the Himalayan border state of Arunachal Pradesh as the head of the nationalist Bharatiya Janata Party (BJP). 'No power on earth can take away even an inch from India. China should give up its expansionist attitude and adopt a development mindset', he declared. 'I swear by this land that I will not let this nation be destroyed, I will not let this nation be divided, I will not let this nation bow down'.¹⁴ Arunachal Pradesh is claimed in its entirety by neighbouring China.

These remarks by the leading candidate for the position of Indian Prime Minister may make sense during electioneering, but will enormously complicate the South Asian situation if they were to become the basis of making public policy. That notwithstanding, there is expectation in the Indian business community that a Modi-dominated administration will have the political will to concentrate on economic matters. According to an assessment in the *Financial Times* published on 24 March 2014, 'capital expenditure levels have plunged in Asia's third largest economy over the last two years as growth slowed. Yet India's stock market rally, in which

¹³ Shahid Javed Burki, Institute of South Asian Studies, China's 'Look-West' Policy: New Link with Pakistan, Brief No. 293, 20 August, 2013. National University of Singapore,

¹⁴ Quoted in Victor Mallet, "Modi chides "expansionist" Beijing ahead of Indian poll", *Financial Times*, 25 February 2014, p. 5.

shares hit another record high is partly based on hopes that this trend will soon reverse post-election, assuming that Mr. Modi's center-right Bharatiya Janata Party wins".¹⁵ For this hope to be realised, a Modi-led New Delhi administration will need to shed the burden of history and work on developing strong economic links with the countries in the neighbourhood, in particular China and Pakistan. If this approach is adopted, it will have enormously positive consequences for the countries of the South Asian region. This was the conclusion that I reached in my book-length study published in 2011 that provided a quantitative assessment of the benefits that will flow to the South Asian nations as a result of greater economic cooperation and integration.¹⁶

Conclusion

The emergence of these two 'quadrilaterals' on Pakistan's borders present the country with more challenges than opportunities. Both these quasi-arrangements will exercise different types of pressures on Pakistan. If Afghanistan moves into the Russian orbit – a development with not a low probability of occurring – it will have both economic and political consequences for Pakistan. It might make the Pashtun population straddling the Afghanistan-Pakistan divide to become more restive, further exacerbating the rise of Islamic extremism in the country. Afghanistan, under the influence of Russia, will pull away not only from Pakistan but also from New Delhi. The Indian policy makers will have to balance their new friendship with those in the US with their traditional ties with Kabul. Washington will try to secure both India and Pakistan to its side to contain the increasingly ambitious and assertive Russia. If the containment of China also becomes a Washington approach to external relations, it will try hard to draw India as a balancer in this equation. In other words, the ground rules for the new Cold War will be fought on grounds different from those that were in place for nearly a half-century between 1945 and 1991. Then the war was between two very different ideologies; now nationalism will be the

¹⁵ James Crabtree, "India pins hopes for capex revival on Modi", *Financial Times*, 24 March 2014, p. 16.

¹⁶ See Shahid Javed Burki, *South Asia in the New World Order: The role of regional cooperation*, London, Routledge, 2011.

basis. And as we know from the history of wars in the 20th century, nationalism can be an enormously destructive force.

There is an irony for Pakistan in this developing situation. While Pakistan for the first time in its history is ready to place economics at the centre of foreign policy making, political considerations are being forced on it by the development of what I have described as the two 'quadrilaterals'. Islamabad's challenge will be to stay on the new course and keep its attention focused on economics while some of the major powers on the global scene move to settle their political positions. From the available indications, the government headed by Prime Minister Nawaz Sharif seems inclined to take that route.

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