

WAR on Terrorism: Impact on Pakistan's Economy

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Abstract

In analyzing the government of Pakistan's policies towards USA in the war against terrorism, this article focuses on Pakistan US relationship and US assistance to Pakistan for economic development. The main concern is to understand the environment of mistrust between the two states and need to analyze that Pakistan's economic development should be based on sound long term economic policies.

In the region of South Asia, Pakistan has the most delicate strategic position. The event of Russian invasion in Afghanistan during cold war period and in the post cold war era, the other world shaking event, the terrorist attacks on World Trade Centre have witnessed that these developments profoundly affected Pakistan's strategic position. The incident of 9/11 affected Pakistan's defence and strategic concerns, its national cohesion, domestic stability and economic condition.

In the wake of 9/11 incident, once again Pakistan gets the status of a front line state, because immediately after the attacks on WTC, the US government approached Pakistan and presented stark choices. It had to either make common cause with Washington in its war against terrorism suspected terrorist bin Laden and his Al-Qaeda network based in Afghanistan with the support of Taliban regime or the second option was to persist with its pro Taliban Afghan policy and live with international condemnation and isolation from rest of the world¹. Washington gave Pakistan twenty four hours to decide, whether it would be on America's side or not² and according to a news report the next day on September 13, President General Pervaiz Musharraf gave green signal to the state department that Pakistan would extend its "unstinted cooperation" to the international coalition against terrorism³.

After the higher official meeting President of Pakistan General Pervaiz Musharraf addressed the nation and presented his policies which were completely reversed direction. In his television address to the nation on September 19, 2001, he clarified,

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“We in Pakistan are facing a very critical situation. Perhaps as critical as the events in 1971. If we make the wrong decisions our vital interests will be harmed, our critical concerns are our sovereignty, second our economy, third our strategic assets, (nuclear, missiles) and fourth our Kashmir cause. All four will be harmed. If we make these decisions they must be according to Islam. It is not the question of bravery or cowardice. But bravery without thinking is stupidity. We have to save our interests. Pakistan comes first everything else is secondary⁴.”

The policies presented in the president’s speech resulted in withdrawal of Pakistan’s support for the Taliban government in Afghanistan and extended cooperation towards USA. Through this speech, he also presented his new strategy to safeguard Pakistan’s national interests based on four key objectives. These were security, protection of Pakistani nuclear assets, settlement of the Kashmir dispute and long term economic development.

Main focus of this paper is to analyze the ambition of this long term economic development with the help of following questions:-

1. To understand the ground realities in which Pakistan joined the US coalition.
2. The situation of Pakistan’s economy when it joined the US led coalition against terrorism.
3. Either the economic assistance given to Pakistan was conditional to the US support on war against terrorism or to improve the basic economic and social condition of Pakistan?
4. What were the expectations of Pakistan and how it was treated by the US government?
5. What should be the future strategy for the improvement of economy and to give the economic benefits to the masses?

Before discussing Pakistan’s macro economic condition when it became the ally of US led war against terrorism, and got economic benefit from US to improve its different sectors it is necessary to discuss Pakistan – US relations as well to understand the environment in which they started a new phase of relationship.

Pakistan – US relations: the environment of mistrust.

In the post cold war period, when US became the sole hegemonic power had changed its policies. The main focus was about the role of USA in the new unilateral world. The US policy was based on the concept of power, security and of course its national interests. In the South Asian region, Pakistan was the only state which promoted US agenda during cold war period and was the ally of US government not only lost its former status but India the traditional ally of Moscow, apparently welcomed Washington and became the focus of US interest as the dominant power in South Asia⁵. In this scenario Pakistan not only relegated the status of a front line state but also to the category of unfavourable nations and alleged to have a tendency towards hostility from the United States and its interests. It has been said that the relationship between both the countries is issue bound and when ever the “issue” lost its importance, it lost all its vitality and vigour⁶. And as Dennis Cux observed in his book, that the common struggle during cold war against the Soviet occupation of Afghanistan no longer cemented U.S Pakistan relation and in the absence of a “shared significant national interests”, tension between the two nations was becoming apparent⁷. Bilateral relations further worsened when Pakistan detonated its nuclear explosions on May 28, 1998 and expedited its nuclear and missile programme. It was considered that Pakistan is a threat to United State’s non proliferation motives in the region.

The American Policy think tanks developed a consensus that Pakistan was not only losing its strategic importance, it was also becoming an unreliable “failed State”, and Islamabad seemed to be emerging as a promoter and supporter of terrorism.⁸ Apart from the nuclear Pakistan the issue of democracy growing strength of radical Islam, bankrupt economy, pro Taliban foreign policy, etc were also the major area of concerns for the US officials. Under this environment of mistrust the September 11, event changed the world scene and opened a new phase of Pakistan – US relationship.

The US media immediately pointed out Osama Bin Laden, the mastermind of these terrorist attacks. Osama Bin Laden with his organization Al Qaida was suspected to have their base in Afghanistan and Taliban government was their supporter. Due to the geographical proximity of Pakistan with Afghanistan, and a day before 9/11 Pakistan was staunch supporter of Taliban. It was observed that Pakistan had to face some difficult days ahead. After the stunning attacks of September 11, 2001 US started to contour his new strategy to counter the situation. President G.W Bush declared the struggle between good versus evil.

Former foreign minister Pakistan Mr. Abdul Sattar wrote in his book that Secretary of State Colin Powell announced that US expected the fullest cooperation of Pakistan and on 13th September President Bush said, those who harboured terrorism would be treated as terrorists. The foreign ministers also mentioned that at a press conference on September 13, 2001, Mr. Bush was asked about any progress in obtaining the cooperation from Pakistan he answered “we will give a chance to cooperate”⁹.

Although, Pakistan and U.S government mutually had the feelings of mistrust and the US media was presenting Pakistan as a promoter of terrorism¹⁰, President Musharraf did an effective job of realigning Pakistan with Washington’s policy. Islamabad not only offered intelligence, air space and logistic facilities against Osama Bin Ladin and his terrorist organization but fired Ahmad Mahmood, Director General of the military run Inter Services Intelligence, Muzaffar Usmani, Deputy Chief of the Army Staff, reputed to be a staunch supports of the Taliban regime. They were replaced by those army officers who had moderate approach compatible to president Musharraf”. President Musharraf’s strategy to be the ally of US in this war against terrorism was not appreciated throughout the state. National and international media repeatedly highlighted the fact that US could not develop a long term strategic partnership with Pakistan because of the diversity of their vision and the status of radical Islamic forces in Pakistan. In LOS Angeles Times, Selig S Harrison wrote the importance of US relations with India as dominant and emerging economic power in South Asia and the right choice for United States to safeguard its strategic interests in the region while he stressed that “if Pakistan is an ally of the United States of America, good luck to the United States of America”¹². But the government of United States knew, that a military government having legitimacy crisis could better serve their interests. The Bush administration moved fast in announcing rewards for Pakistan for the cooperation.

In the next few weeks most sanctions relating to May 1998 Nuclear blasts and October 10, 1999 military coup were lifted and it was announced that Pakistan would receive well over one billion dollars as U.S assistance and that the U.S would support Pakistan’s case for additional loans and for debt rescheduling.

Reflections of Pakistan’s Economy

In spite of this uncertain and unreliable environment Pakistan gave a warm welcome not only to the US assistance but the US policies towards Pakistan also. The main reason was the destable and fragile economy of Pakistan that was the fruit of a destable political system. The following table, growth performance of real sector in Pakistan would be helpful to evaluate the economic situation of Pakistan at that time.

**TABLE 1.1
GROWTH PERFORMANCE OF REAL SECTOR**

Item	Unit	1980s	1990 1995	1995 2000	2000 2001	2001 2002
A. GDP Growth Rate	%	6.1	4.9	4.0	2.5	3.6
a. Agriculture	%	4.1	4.2	4.9	-2.6	1.4
b. Manufacturing		8.2	4.8	3.2	7.6	4.4
c. Large scale Manufacturing	%	8.2	4.7	2.4	8.6	4.0
d. Services	%	6.6	5.1	4.0	4.8	5.1
B. Total Investment	As % of GDP	18.6	19.5	17.1	15.9	13.9
a. Fixed Investment		16.8	18.0	15.3	14.3	12.3
b. Public Investment		9.1	8.6	6.4	6.3	4.7
c. Private Investment		7.8	9.4	8.9	8.0	7.6
C. National Saving	As % of GDP	14.7	14.9	12.7	15.1	15.4
a. Domestic Saving		7.7	13.9	13.8	16.5	14.7

Source Economic Survey 2001-2002

Pakistan's weak and fragile economy was heavily dependent on a variety of external capital flows. The main official and private sources of capital flows in Pakistan could be shown as in the table 1.2

**TABLE 1.2
SOURCES OF EXTERNAL CAPITAL FLOWS TO PAKISTAN**

OFFICIAL	PRIVATE
Multilateral Institution	- Foreign Direct Investment
IMF Purchases	- Profit capacity investment.
IDA Concessional Loans	- GDR Flotations.
IBRD / ADB	- Asset backed securities.
- non concessional loans	- Private Placement
- Balance of Payment Support	- Commercial bank medium term loans.
- Project aid.	- Short term Swap loans
Grants from the UN system EU.	- Foreign currency deposits
- Bilateral Donors Grants.	- International bond issues (Euro bonds).
- Technical Assistance	- Short term commercial loans.
- Projects	- Rade Financing
Confessional loans	
Export Credits	

Commodity and Food Aid	<ul style="list-style-type: none"> - Workers remittance - Deposits of Foreign banks in the Central bank.
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Source: Ishrat Hussain, Pakistan the economy of an elitist state, (Karachi: Oxford University Press, 1999) p. 420

The external capital flow towards Pakistan through the mentioned sources was severely disturbed by its nuclear detonations in 1998. All the official donors to Pakistan like IMF, World Bank, ADB and Japan withheld their support and imposed sanctions on Pakistan's economy. Resultantly, the balance of payment became highly vulnerable and the country's debt situation became worsened.

From 1998 to 2001, economic situation of Pakistan was highly destable. Foreign exchanged reserves were not sufficient¹³, financial indiscipline was there. The international rating agencies had downgraded it to a selective default level likely the September 11, event also directly or indirectly affected Pakistan's economy and it has been said that regular orders were cancelled or got delayed, investors lost their confidence, travel to and from Pakistan became difficult. This was a brief picture of Pakistan's economy when it joined the US coalition against terrorism as a front line state.

It was observed that as an important ally Pakistan's stability is of vital impotence to the international community. Analyzing this factor, US government offered a strong support to Pakistan's military leader General Pervaiz Musharraf The extended support from U.S was related to lifting up the sanctions that had been imposed on Pakistan after its nuclear explosions in 1998 and after General Musharraf's 1999 Coup suspended democracy. In this way the Glenn, Symington and Presseler amendments were lifting up and US government provided legitimacy to General Musharraf's govenrment¹⁴. Washington also agreed to reschedule Pakistan's outstanding debt to the United States of about 400 million and to support loan rescheduling by various financial institution, including the World Bank, IMF and ADB, thus helping to alleviate Pakistan's 38 billion foreign debts.

Washington also offered General Musharraf an aid package of nearly \$1 billion for different purposes including, border control, refugee assistance and poverty alleviation¹⁵. By the end of 2001, IMF and the Paris Club pronounced themselves pleased with Pakistan's economic progress and rescheduled much of its foreign debt and extended fresh credits¹⁶. The Pakistani government was mind full of the vale and importance of its contribution to the war against terrorism. According to Pakistan embassy

official in Washington, D.C, “Pakistan has deployed more than 70,000 of its troops to the Afghan border and has launched more than 38 major successful operations to flush out foreign terrorists. More than 300 Pakistan army and paramilitary troops have been killed, and an even larger number injured, accounting for more casualties than any other US ally in the war on terrorism. Pakistan is the only regional country to participate in the coalition maritime interdiction operations, the maritime component of operation Enduring Freedom. Additionally, the intelligence provided by Pakistan has led to successes against terrorism around the world. For example, all of the top Al-Qaeda leaders captured to date have been apprehended in Pakistan with the government’s help, while Pakistan itself has arrested more than 700 terrorist suspects. The country has also banned or placed on watch lists a large number of sectarian and militant organizations and enacted numerous antiterrorism laws, freezing 32 bank accounts suspected of belonging to terrorist organizations¹⁷”. For all the above mentioned services, Pakistani government was expecting a high level of foreign investment, flow of aid on his own priorities, market access to Europe and the West and long term bilateral economic relationship. A study from 2001 upto December 2006 gives us the real picture and helpful to analyze the costs and benefits of this alliance.

**Washington’s Rewards for Pakistan
Initial Estimates and Outcome**

United State’s announced actual and budgeted amount of aid for Pakistan during the period of 2001-08 total \$5.174 billions. It is also estimated that an additional \$80 - \$100 million are given each month in coalition support fund a total of \$ 4.75 billion until August 2006. The description of covert transfer of funds is publicly not available. The detail of US assistance to Pakistan from 2001 to 2006 could be checked through this table.

**TABLE 1.3
U.S ASSITANCE TO PAKISTAN, FY 2001 – FY 2006
(IN MILLIONS OF DOLLARS)**

Program or Account	FY 2001 Actual	FY 2002 Actual	FY 2003 Actual	FY 2004	FY 2005 Estimate	FY 2006 Request
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				Actual		
CSH	-.-	5.0	15.6	25.6	21.0	20.5
DA	-.-	10.0	34.5	49.4	29.0	29.0
ERMA	-.-	25.0	-.-	-.-	-.-	-.-
ESF	-.-	624.5	188.0 ^a	200.0 ^a	297.6 ^a	300.0
FMF	-.-	75.0	224.5	74.6	298.8 ^b	300.0
IMET	-.-	0.9	1.0	1.4	2.0	2.0
INCLE	3.5	90.5 ^c	31.0	31.5	36.2 ^b	40.0
NADR	-.-	10.1	-.-	4.9	7.0	6.7
PKO	-.-	220.0	-.-	-.-	-.-	-.-
Subtotal	\$3.5	\$1,061.0	\$494.6	\$387.4	\$691.6	\$698.2
P.L 480 Title 1 ^d	0.5	10.0	9.0	6.0	-.-	-.-
P.L. 480 Title 11 ^d	1.9	5.1	9.7	8.4	-.-	-.-
Section 416(b) ^d	85.1	75.7	-.-	9.6	-.-	-.-
Total	\$91.0	\$1,151.8	\$513.3	\$411.4	\$691.6	\$698.2

Sources: Congressional Research Services, issued 26.07.05 Page 16.

Abbreviations:

CSH:	Child Survival and Health	NADR:	Nonproliferation, Anti-Terrorism, Demining, and Related
DA:	Development Assistance	PKO	Peace keeping Operations
ERMA:	Emergency Refugee and Migration Assistance	P.L.480 Title I:	Trade and Development Assistant food aid (loans)
ESF:	Economic Support Fund	P.L. 480 Title II:	Emergency and Private Assistance food aid (grants)
FMF:	Foreign Military Financing	Section 416(b)	The Agriculture Act of 1949, as amended (surplus donations) s
IMET:	International Military Education and Training		
INCLE:	International Narcotics Control and Law Enforcement (includes border security)		

It was noted that Pakistan has become the biggest beneficiary of economic aid in return for its support of the U.S. antiterrorism campaign in Afghanistan¹⁸. In spite of this blessing, the economic condition of Pakistan did not show desired improvement. In the fiscal year 2001, the ratio of inflation was 4.4% and in fiscal year 2006, it was increased to 7.9%.

TABLE 1.4
Inflation Rate (CPI)

ITEM	2003-04	2004-05	JULY – APRIL	
			2004-05	2005-06
CPI (General)	4.6	9.3	9.3	8.0
Food Group	6.0	12.5	12.8	7.0
Non-Food Group	3.6	7.1	6.9	8.8
Core Inflation	3.7	7.0	7.0	7.7

Source Pakistan Economic Survey, pp. 119 – 121.

Despite sizable export gains, trade deficit also increased from \$4.3 billion to \$8.62 billion in 2006¹⁹. In the same way, the ratio of foreign debt is also increased in millions of dollars.

TABLE 1.5
EXTERNAL DEBT AND FOREIGN EXCHANGE LIABILITIES (\$
BILLION)

Item	2000	2001	2003	2004	2005	2005
1. Public & Publicly Guaranteed Debt	27.804	28.165	29.23	29.875	31.084	31.821
A. Medium & long term (Paris Club, Multilateral and Other Bilateral)	25.301	25.606	28.07	28.627	29.177	29.403
B. Other medium & long term (Bonds, Military & commercial)	2.373	2.302	0.976	1.226	1.636	2.210
C. Short Term (IDB)	0.13	0.257	0.187	0.022	0.271	0.208
2. Private Non-guarantee Debt	2.842	2.45	2.028	1.67	1.342	1.588
3. IMF	1.55	1.529	2.092	1.762	1.611	1.494
Total External Debt (1 through 3)	32.196	32.144	33.35	33.307	34.037	34.903
4. Foreign Exchange Liabilities	5.664	5.015	2.122	1.951	1.797	1.654
- Foreign Currency Accounts	1.733	1.1	0	0	0	0
Total External Liabilities (1 through 4)	37.86	37.16	35.47	35.26	35.834	36.557

Source: Economic Survey of Pakistan p. 80

The total before tax profit of commercial banks was 5.2 billion rupees in 1999 that was increased upto 93.2 billion rupees in 2005, but during this period average Profit on PLS accounts was reduced from 7% to 2.5% that seemed the worst type of exploitation. This is a brief picture of the deteriorated economic situation need to be analyzed that what was the use of heavy aid given to Pakistan and why the benefits are not trickling down to the masses.

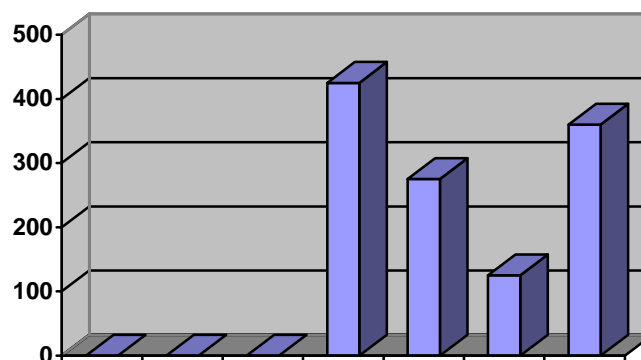
Reasons of the Deteriorating Economic Condition.

The US aid figures for 2001-2007 reflect 1.2 billion dollars in FMF (Foreign Military Financing) 1.9 billion dollars in economic support fund, 111.7 million for child survival and health and a token of 64 million dollars for the promotion of democracy. These details were analyzed by Hussain

Haqqani, he said, “the allocation for child survival and health amounts to less than a dollar per person, given the size of Pakistan’s population²⁰.”

Most of the American aid money has gone to modernize the military because all U.S assistance is conditional to Pakistan and the U.S Congress approved this aid on the required certification by president Jorge W. Bush that Pakistan will continue its support on antiterrorism war, establishment of democracy and not to export nuclear technology.

**Figure 1 Security related U.S Assistance to Pakistan, FY 2001 _ FY 2005
(In millions of Dollars)**



Source Congressional Research Service p. 27.

The image of Pakistan is also shattered on the international scene due to continuous warnings and comments from the US officials, and think tanks of anti Pakistan Lobby. On the North Korean nuclear issue, Pakistan was alleged to support their nuclear programme²¹. On Kashmir front, Pakistan is accused as a platform for terrorism. U.S Officials accused that “one month after the Pakistan government agreed to end its support of the Taliban, its intelligence agency was still providing safe passage for weapons and ammunition to arm them²². They also alleged that hundreds of Pakistani military officers and ISI agents provided support to the Taliban forces²³. These off and on accusations are not only a warning signal for Pakistan but are also seriously damaging the investment climate in Pakistan.

It has become a general perception in Pakistan that U.S government neither interested to establish long term bilateral economic relationship with Pakistan nor it will support the democratic government in Pakistan. This perception is being strengthened by the figures provided by the United States Agency for International Development (USAID) between

1954 and 2002, the US provided a total of \$12.6 billion in economic and military aid to Pakistan. Of these \$ 9.19 billion were given during 24 years of military rule while only \$3.4 billion were provided to civilian governments. This time once again different circles within and out side Pakistan claims that United States has developed their relation with General Musharraf's Military Government not with the State of Pakistan. According to a congressional Research Survey Report Presented on March 31st 2007.

“Pakistan would probably be on firmer footing through conditioned programmes more dedicated to building the country's political and social institutions than rewarding its leadership.”²⁴

Conclusion

Pakistan's support to fight against terrorism has not been reciprocated by the US government in the same spirit and the sincerity as shown by Pakistan. The accelerated growth in Pakistan was not due only to the US financial support or facilitation. Pakistan as a nuclear power is too precious for the entire world. The developed world would not like Pakistan to crumble as it would create chaos and might land the nuclear arsenal in wrong hands. The support in war against terror to the US has infact proved to be counter productive for Pakistan's economy. As a front line state against war on terrorism Pakistan is subjected to many restrictions. There is a travel advice to the western citizens against travel to Pakistan. Pakistan conducts most of its trade with the US and European Union infact more than 50% of our exports go to these two destinations. After travel advice, the foreign buyers are reluctant to visit Pakistan. Many reputable international buying houses that established their offices in Pakistan before 9/11 for procurement of value added textiles from not only Pakistan but the entire region have shifted to Singapore, Hong Kong and India. Pakistani businessmen are subjected to strict scrutiny for grant of visa. The visas to lucky few are issued after considerable delayed. The one to one contact of Pakistani businessmen with their foreign counterparts has been restricted or completely denied. This has adversely impacted Pakistan's exports. The foreign buyers have exploited the situation to procure goods at lowest values. Pakistani knitwear is better in quality than its competitors but fetch the lowest rates due to the denial of direct contact with outside businessmen. The economy that was termed in the late 90's as the elitist economy by Dr Ishrat Hussain has become more tilted towards the rich. The benefits of high growth have largely benefited the rich. Infact only those benefited from the high growth that had contacts with the out side world before 9/11.They gathered orders on their past interaction and

reputation while new entrants were denied market access due to travel advice or visa denial.

Despite the concessional inflows of foreign aid, Pakistan faces different economic, social and political problems. There is massive income disparities, thirty one percent of Pakistanis live below the poverty line. Pakistan's public spending on social sector like health, education, housing are among the lowest in the region. The government of Pakistan must ensure that the fruits of Pakistan's economic recovery trickle down to the people of Pakistan. For the actual promotion and development of Pakistan's economy following policy options are required.

- Not aid but trade is necessary.
- U.S. should give market access to Pakistan for its textile sector especially,
- Transfer of technology is required that will provide Pakistan a base for competition in the region.
- Joint economic ventures should be made. These will helpful to create Pakistan-US long term bilateral relationship and will remove the image of Pakistan as a client state.
- Visa restrictions should be eased for the Pakistani businessmen and exporters.
- Two third of U.S aid should be reserved for the development of economic programmes and one third to security assistance.
- Consistency in economic policies should be ensured through stable political government.
- Civil and political institutions should be strengthened, their strength will ensure economic stability.

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