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# Impact of Terrorism on The Economy of Pakistan

\_\_\_\_\_ Asifa Khalid  
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The purpose of this study is to analyse the effects of the two major factors of terrorism and political instability on Pakistan's economy. Pakistan's involvement in US war with Afghanistan along with sectarian and ethnic conflicts, are the main sources of spreading terrorism in Pakistan. This situation became the major cause of slowing down economic growth in Pakistan. In this study the positive and negative impacts of terrorism have been presented. After Pakistan's participation in war against terror, the flow of foreign aid picked up but this aid was not for the development projects, it was just for the defense purpose. Terrorism caused much uncertainties as well as destruction in the country. The burden of the largest number of IDPs in the history of Pakistan badly effected Pakistan's economy. Terrorism is also a cause of closure of many industries in Pakistan. Pakistan's security situation gave a bad impression to foreign tourists. Foreign aid could not recover all the losses which Pakistan had to face due to terrorism. Pakistan had need technological and economic assistance for promoting industries and institutions to uplift its economy. In spite of limited resources and weak economy, Pakistan has spent a huge sum on operation against the militants groups. Pakistan participation in Us war against terror put extra burden on Pakistan's economy.

## **Introduction**

Pakistan has experienced different types of government such as military dictatorship and elected democracy and her economy has also undergone many ups and downs. The global and internal issues have always affected Pakistan's economy. Paradoxically whenever the military rule was imposed on Pakistan, the inflow of foreign aid was accelerated assupport against the international phenomenon of terrorism.

Terrorism is not a new phenomenon but it got much importance after 9/11 incidence. The Middle East and South Asia were effected by terrorism more than other regions of the world. Pakistan as a neighboring state of Afghanistan was affected from terrorism more than any other state and also became once again a front -line state. Terrorism has affected the developing economies more than these developed economies. "In fact, terrorism affects developing countries much more

severely than developed ones, as developed countries have diverse economies and terrorism results only in reallocation of resources to more secure sectors of the economy, while in case of developing countries, where there is much concentration of resources in certain sectors, are more affected.”<sup>1</sup>

However, terrorism is tinted from religion and sectarianism but it’s seeds like economic deprivation, social injustice, absence of rule of law and insufficient opportunities can’t be ignored.

There is no universal definition of terrorism but Tariq Khan states, “Terrorism means harassment, destruction, suicide attacks and killing of innocent people for no reasons.” Terrorism has also been defined as, “the premeditated use or threat of use of violence by individuals or sub-national groups to obtain a political or social objective through the intimidation of a large audience, beyond that of the immediate victim.”<sup>2</sup>

Pakistan has been facing many economic and political problems like sanctions due to nuclear tests, military coups and terrorism. Pakistan was considered as a no go area for foreign investors and businessmen who did not like to visit Pakistan. Economic situation was however changed when Pakistan became a front- line state in war against terror. Sanctions were removed; debt was either rescheduled or written off and remittances into Pakistan picked up significantly. The 9/11 incident occurred in the start of Musharraf era and flow of foreign aid picked up. Foreign reserves increased from \$ 700 million to \$ 17 billion within a few years. The Karachi Stock Exchange was declared as the “best performing in the Asian markets” and got the third rank in banking profitability. The growth rate of GDP increased from 3.29% in 1999-2000 to 6.83% in 2003-2008, per capita income increased and positive economic outcomes emerged. Investment and exports grew up. However, the benefits of this economic improvement were for the elite class as the common man was still waiting for benefits to trickle down. Consequently, income disparity increased.<sup>3</sup>

Although the economy of Pakistan improved during Musharraf regime but this improvement could not remain stable as this government also failed to present any visible strategy for economic development. (The fundamentals of economic sectors could not be improved. The number of people living under poverty line increased, in spite of higher flows of foreign aid and World Bank’s anti-poverty reduction programme . Under Musharraf’s administration, nepotism, corruption, inequality and unemployment were augmented.<sup>4</sup>

Consequences of this economic progress on weak foundations started to emerge in PPP regime (2008-13). Trade deficit increased to \$ 15 billion in 2008 from \$ 10 billion in 2007. The prices started to rise from an annual rate of 12% in 2005 and reached a level of 20% in 2008<sup>5</sup>.

The collapse of Pakistan’s economy, paved the way for economic and social injustice and let the state toward further political instability. Unfortunately

Pakistan is a politically unstable state. Political instability had a negative impact on foreign investors.

**Participation in War against Terror and inflow of US aid**

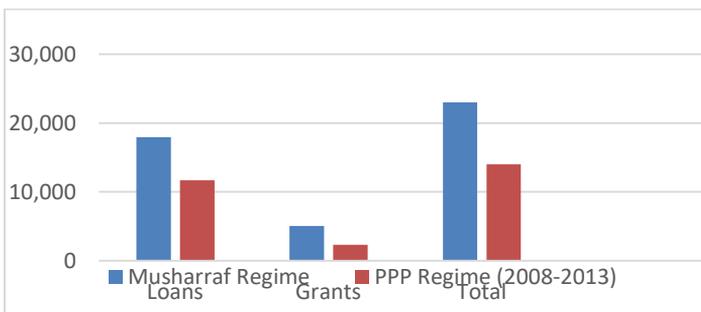
Pakistan’s economy experienced rapid growth during Musharraf’s era. The average GDP growth was recorded at 5.2%. The inflow of foreign aid can be identified as a major cause of this growth. Musharraf government also signed one year Stand-by-Agreement (SBA) equivalent to \$ 596 million in June 2000. Due to its successful implementation, the government also adopted *Poverty Reduction Growth Facility (PRGF)* agreement of \$ 1.3 billion in December, 2001. After Musharraf, the elected government of PPP also entered into SBA of \$ 7.6 billion in October 2008 for 23 months. It was raised to \$ 11.3 billion in August, 2009 and was also extended by nine months till September 2011. During this period, the economy was under IMF programme while these loans rescued the Pakistan’s economy<sup>6</sup>.

During the PPP regime (2008-13), foreign aid was reduced as compared to aid inflows during Musharraf’s regime. See Figure 1.1. Pakistan economy showed poor performance and reduction of foreign aid could be one of its reasons. As foreign aid was reduced, Pakistan’s economy suffered a slowdown. So this growth can be termed as borrowed growth. The borrowed growth was defined as,

“that growth which is financed through borrowing and at the same time remains dependent upon external factors outside the control of policy makers.”<sup>7</sup>

Fig 1.1

Foreign Aid Inflows during Musharraf and PPP Regime (2008-13) \$ Millions



Source : Zafar Mueen Nasir, “The Impact of Foreign Aid on Pakistan in post-9/11 Scenario”, World Times, December 5, 2012.

In 2001 Pakistan faced the worst economic situation. The per capita income was low and the rates of poverty and unemployment were high. In the start of the year 2001-02, there were limited foreign exchange reserves at \$3,231 million could finance the imports only for three months. After the participation in war against terror, “inflow of concessional assistance” and assistance in the shape of US grants

increased. From 2001-02 to 2007-08 the US funding for Pakistan was recorded at \$ 12.2 billion but almost 70% this was reserved for counter terrorism operations. See Table 1.

Table 1: US Funding to Pakistan from 2001-02 to 2007-08 \$ Million

Purposes	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Military	1465	1473	782	1273	1218	1095	1387
Law enforcement	100	32	36	40	46	31	31
Development & economics	665	258	304	405	677	442	445
Diplomacy	3	4	7	6	9	9	1
Total	2232	1767	1129	1724	1951	1578	1866

*Source:* US accountability office, securing, stabilizing and developing Pakistan's Border with Afghanistan February 2009

Assistance for development was recorded at \$ 3.2 billion in the same period. The overall inflow of aid increased the foreign reserves to a level of \$ 12,389 million at the end of 2003-04. The foreign aid not only boosted the foreign reserves but it also expanded the money supply, interests rates were reduced and the economy started to grow up.

According to statistics collected by the US authorities, if \$ 14.573 billion cost of "logistics and aerial support" was excluded, the approved aid to Pakistan for security and civilian matters would come to only \$ 18.8 billion from 2002 to 2016. However, due to war against terror, Pakistan had to face losses of \$ 123.13 billion during the same period. The US economic assistance to Pakistan started declining from 2014 and reached a level of \$ 1.6 billion per annum from \$ 2.3 billion per annum during the period of 2002 to 2013.<sup>8</sup>

### Cash Payment to Pakistani Government

Pakistan was included in those four countries which received budgetary support from the USA. *The Center for Strategic and International Studies* presented a report, claiming that direct cash transfers "provide balance of payments, budget, and policy reform support to the Government of Pakistan during this time of economic hardship and political strain associated with Pakistan's participation in the war on terrorism."<sup>9</sup>

This budgetary support has been used for economic stabilization, improvement of education and health, provision of clean water, structural reforms and earthquake relief. But this budgetary support was not beneficial for Pakistan. As Azeem Ibrahim has suggested, "Pakistan's economy has not benefited from the budget support; only an IMF loan in late 2008 prevented it from collapsing."<sup>10</sup>

### **Ineffective Aid in FATA**

Sixty percent of FATA's population has been living below the poverty line while half of this population had no access to clean water and female literacy rate was only 3%. Due to specific Pakhtun code of life, and tribal loyalties, the US was unpopular in some areas. Some aid agencies found themselves counterproductive if they declared that development program is funded by the US. Sometimes, the US had to rely on contractors for the implementation of the projects and the money which was allocated for Pakistan, mostly ended up in contractor countries<sup>11</sup>.

*The Center for Strategic and International Studies* remarks, "the process of building schools and opening health clinics is unlikely to produce development in any broad sense. What is more likely... is that the system of patronage used to maintain political authority will also co-opt the development funds provided to the tribal areas.... Although a few residents may benefit from the assistance, the money may not alleviate poverty in the tribal areas in any meaningful way."

### **Aid for military purposes not development purposes**

From 2002 to 2010, the USA had allocated almost \$ 19 billion as aid to Pakistan and the average was more than \$ 2 billion of each year. From 2002 to 2008 almost 10% of the aid was for the purpose of development while 75% of money was for military purposes. In subsequent years the share for development had increased but it was still less than half<sup>12</sup>.

USA also started implementing the strategy for the development of Pakistan's frontier and tribal areas. But regarding the implementation of these development policies, there are various insurmountable problems and hurdles specific to these areas. "The frontier regions are not the most hospitable terrain at the best of times, and with a war taking place in the region, most American development efforts will be compromised. The Pakistani government, unfortunately, has been unwilling to do all it can to develop FATA or even the rest of Pakistan, and increase the effectiveness of American aid"<sup>13</sup>.

### **CSF and PCF: Security related aid**

The Coalition Support Fund (CSF) was also designed for supporting the cost of military operations. Almost 60% of the total aid was the part of the CSF. Robert Gates, former US secretary of defense points out that, "CSF payments have been used to support approximately 100 Pakistani army operations and help to keep some 100,000 Pakistani troops in the field in northwest Pakistan by paying for food, clothing and housing. They also compensate Islamabad for coalition usage of Pakistani airfields and seaports"<sup>14</sup>.

In 2009 a new type of aid, *Pakistan Counterinsurgency Fund* and *Counterinsurgency Capability Fund* was introduced for the similar objectives like CSF and its focus increased on fighting insurgency in Pakistan like Swat operation of 2009.

The share of US economic aid was much lower in the total aid until 2009. The purpose of this aid was to support counterterrorism, not providing economic assistance for the development of education and health sectors. From 2001 to 2008 only 25% share of this aid was allocated for development including food aid. An amount of \$ 5.8 billion as aid was allocated for FATA while the major focus was on ‘counterterrorism and counterinsurgency in Pakistan.’ Nearly 96% of this aid was spent for military operations and only 1% for development<sup>15</sup>.

### **Kerry Lugar Bill**

After 9/11, US provided aid to Pakistan for counterterrorism which was not helpful for the improvement for the life of common man and this could not be successful for achieving the purpose of counterterrorism.

Through Kerry Lugar Bill the US tried to change its purpose of aid. The aid through KLB was provided for economic growth, energy, education, health and agriculture sector. Pakistan received \$ 6070 million in 2010-11, \$ 227.6 million in 2011-12, \$ 67.2 million in 2012-13, \$ 157.4 million in 2013-14, \$ 51.3 million in 2014-15 and \$ 2.9 million in 2015-16. Assistance through KLB amounted to Rs 1.5 billion per year from 2010 to 2014 while Rs 7.5 billion was provided for civilian assistance from the whole package. According to the US Embassy spokesperson, "The Enhanced Partnership with Pakistan Act of 2009, known as Kerry-Lugar-Berman (KLB), authorized appropriations for fiscal years 2010 to 2014 to promote an enhanced strategic partnership with Pakistan and its people. During those fiscal years, the United States committed \$5 billion in bilateral civilian assistance, plus another \$1 billion in emergency humanitarian assistance in response to natural disasters and conflict." Pakistan received \$ 4.681 billion from October 2009 to September 2014 against the commitment of \$ 5 billion and \$ 1 billion for emergency assistance<sup>16</sup>.

The KLB was launched during PPP era and the purpose of this bill was to provide aid to agriculture, energy and social sectors. But all these sectors performed poorly. Energy sector started to decline and circular debt contained rising during the PPP tenure. The Social sector and agriculture sector also showed poor progress. See Table 2

Table 2: Economic Growth during PPP Regime (2008-13) (as %)

Years	GDP	Agriculture	Manufacturing	Commodity producing sector	Services Sector	Expenditure on Education	Expenditure on Health
2008-09	0.4	3.5	-4.2	-0.9	1.3	1.8	0.5
2009-10	2.6	0.2	1.4	1.8	3.2	1.7	0.5
2010-11	3.6	2.0	2.5	3.2	3.9	1.8	0.2

2011-12	3.8	3.6	2.1	3.1	4.4	2.0	0.3
2012-13	3.7	2.7	4.9	1.7	5.1	2.1	0.6

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Source: Pakistan Economic Survey 2016-17

In fact, the aid related to humanitarian and economic development remained overshadowed by the aid for the military purposes.

### **Lifting the sanctions**

After the successful nuclear tests on May 28, 1998 by Pakistan the USA imposed sanctions on the country. All donors like World Bank, ADB, IMF, Japan withheld financial aid to Pakistan. Consequently Pakistan's balance of payments deteriorated and Pakistan's economy reached a vulnerable stage. Pakistan's government was negotiating with the IMF for multilateral aid packages like *Poverty Reduction and Growth Facility (PRGF)*. The USA was not in favour of this request from Pakistan before IMF. After 9/11 incident, the first thing that President W. George Bush had to do, was to remove these sanctions, not only from Pakistan but also from India. Removing these sanctions meant that now USA would be in the favour of these multilateral aid packages<sup>17</sup>.

Remittances inflow in Pakistan especially from USA rose substantially. It is also argued that if the New York attack had not occurred, it was impossible for Pakistan to take itself out from nuclear test related sanctions and negative consequences of fourth military coup<sup>18</sup>.

### **Losses due to participating in the war against terror**

Pakistan had to bear heavy burden of war against terror. The Terrorist activities increased and it destroyed the peace and stability of Pakistan and the image of Pakistan in the international world was tarnished. Pakistan is an economically deprived country. The War on terror has left numerous negative implications for Pakistan's economy.

Pakistan had to pay direct and indirect costs. As a major outcome, the domestic economic activity slowed down. Unemployment increased in affected areas like KPK and FATA. Pakistan's tourism industry was damaged badly. Millions of displaced people had also affected Pakistan's economy negatively. Development projects of FATA and KPK were adversely affected by the terrorist attacks. Pakistan had to pay three times higher cost at \$ 6 billion annually, from the aid of \$1.9 billion per annum which it received from the USA, so the benefits received by Pakistan for participation in this war fell steeply in 2007-08. "The cumulative cost of the war on terror from 2001-2002 to 2010-2011 is estimated at \$ 67.9 billion."<sup>19</sup>

Pakistan had to face losses in several sectors due to terrorist attacks. In FY 17 to FY 18, the total loss of compensation to affected was recorded US \$ 1,29.89

million, total loss of physical infrastructure was recorded at \$ 383.83 million, loss of foreign investment was at US \$ 1,234.40 million, loss of privatization was calculated at \$ 251.19 million, industries faced the loss of US \$ 1043.90 million, loss of tax collection was recorded at US \$ 3,459.69 million, cost of uncertainty was recorded at US \$ 85.24 million, expenditures over run were US \$ 939.37 million. See Table3.

Table 3: Losses due to terrorist attacks

Sr.no	Organizations	Years		Total
		2016-17	2017-18 (July-March)	
1	Compensation to Affectees	90.64	39.25	129.89
2	Physical Infrastructure	272.32	111.61	383.93
3	Foreign Investment	1,105.30	1,129.10	1234.40
4	Privatization	251.19	0.00	251.19
5	Industrial output	594.300	449.600	1043.90
6	Tax Collection	2,483.29	976.38	3459.67
7	Cost of Uncertainty	71.060	14.180	85.24
8	Expenditures Over run	593.72	345.65	939.37
9	Others	7.07	8.66	15.73
	<b>Total Losses</b>	<b>5,468.89</b>	<b>2,074.43</b>	<b>7543.32</b>

Source: Pakistan Economic Survey 2017-18

### Effects on Business and Industries

After 9/11 incident, there was huge fear and insecurity within the Muslim world. The Muslim countries were considered as insecure places for business and installing industries. Pakistan was also included in this category. The US business community treated Pakistan with distrust. It means that they were not willing to invest in Pakistan. Travel advisories also prevented investors from visiting Pakistan. Pakistan has become a backyard for US “war against terror and war in Afghanistan”. Many of Al-Qaeda members took refuge in Pakistan. Pakistan became “no go” territory for foreign businessmen or donors. Consequently, Pakistan’s industry suffered badly. Industrial sector became indirect victim of terrorism. Manufacturing sector showed poor performance. Small industries for consumer goods were influenced by terrorism<sup>20</sup>.

### Effects on Tourism Industry

Decline in tourism industry is a natural outcome of terrorism. People like to visit the safe and secure places. In Pakistan, tourism industry started to suffer seriously after the launching of war against terror. The occupancy rate of hotels reduced from 60% to 40% in 2007-08. The tourism sector of only Swat valley suffered a loss of

Rs 60 billion from 2007 to 2009. As a tourist destination, Pakistan was ranked at 113 out of 130 countries in 2009. This low rank could be attributed to terrorist activities in the country<sup>21</sup>. Due to the closing of numerous tourism industries, many people had become jobless.

According to Pakistan Association for Tourism's statistical report, before 9/11 incident, 1 million tourists on the average used to visit Pakistan annually but after the occurrence of terrorism, it dropped to 10,000. Before the attack on WTC, 20 to 25 thousands people on the average had visited Gilgit- Baltistan, after 9/11 their strength remained only 5 to 10 thousands<sup>22</sup>.

In 2017, Tourism sector showed some improvement and its contribution in GDP was 2.9% while in 2016 its contribution was 2.7% in the country's GDP. However, Pakistan's tourism sector improved in 2017 as compare to 2016 but it was far behind from India. India's tourism sector contributed 6.88% in the country GDP. India earned US\$ 27 billion from foreign tourists in 2017 on the other hand Pakistan earned US\$ 6.64 billion in the same year.<sup>23</sup>

After some improvement in security conditions in Pakistan the number of tourists increased and it was recorded at 1.75 million in 2016.<sup>24</sup> While those states which are not suffering in terrorism have higher number of international tourists than Pakistan e.g in 2017 the number of visitors in France recorded at 86.9 million, USA attracted 76.9 million tourists, China 60.7 million, Mexico 39.3 million, United Kingdom 37.7 million, Turkey 37.6 million, Germany 37.5 million and Thailand 35.4 million.<sup>25</sup>

### **Loss of human lives**

In the Economic Survey 2011-12, the Government of Pakistan has presented estimates of human lives lost due to terrorist attacks. According to Survey, 3,500 Pakistan's security men and 35,000 civilians were killed within a decade (from 2001 to 2011)<sup>26</sup>. This number was higher than that of USA, the country which initiated the war against terror.

However, Pakistan's rank improved in Global Terrorism Index (GTI) 2017 with 5<sup>th</sup> rank out of 163 countries. It was the best result in the decade. According to GTI 2017, deaths due to terrorism in Pakistan were recorded at 6% while in India it was only 2%. The total deaths in Pakistan from 2001 to 2017 have been recorded at 16,773. (There is wide difference between the estimates of Pakistan Economic Survey and GTI). The death rates due to terrorism declined 11% from 2016 to 2017, a decrease from 957 to 852 respectively and in 2017 it was 64% lower than 2013.<sup>27</sup>

### **IDPs' problem**

Emerging of IDPs in a large number was also one of the serious consequences of war against terrorism. Hafiz Pasha has pointed out that *The National Disaster Management Authority (NDMA)* registered 337,772 people from KPK and FATA

who had to leave their homes due to the country's security situation, while 70% people belong to FATA. *Amnesty International* estimated that the number of IDPs was higher than 500,000. The annual cost for the one third IDPs was recorded at Rs 2 billion.

*Pakistan Institute of Peace Studies* has estimated that from 2.7 million to 3.5 million people were displaced from KPK and FATA due to military operations and it could be considered the largest displacement in the history of Pakistan. From the South Waziristan, 428,000 people were displaced, from Orakzai agency 400,000 people had to leave their homes, from Malakand agency 383,190 people were displaced while 382,950 people had returned to their homes, from the Khyber agency 84,000 to 100,000 people were uprooted and from Bajuar and Muhmand agencies 750,000 people had to leave their homes<sup>28</sup>. Due to militancy, people suffered physical and psychological traumas. Fear traumatized their lives<sup>29</sup>. These IDPs had to leave their businesses. Now most of them had become unemployed. So the burden on Pakistan's economy increased manifold.

Many of the IDPs had to lose their property after the migration and Pakistan's economic condition was not strong enough so as to provide full economic security to such IDPs.

According to Fernando Cavalcante, "The virtual collapse of Pakistan's economy makes any financial assistance or economic compensation for the returnees almost impossible. Islamabad cannot even enforce property rights, hampering the conditions of those people who, after returning, found their homes occupied by others."<sup>30</sup>

Benefits for participation in war against terror began to fall very soon and its negative consequences started to emerge. Pakistan had to face economic and social losses at a massive scale.

"Destruction of infrastructure, internal migration of millions of people from the parts of North Western Pakistan, erosion of investment climate, nose-diving of production and growing unemployment and brought economic activity to a virtual standstill in many parts of the country. Pakistan had never witnessed such devastating social and economic upheaval in its history, even after dismemberment of the country by direct war."<sup>31</sup>

### **Conclusion and Recommendations**

The costs of war against terrorism were much higher than its benefits, The costs are associated with the burden of supporting a large number of IDPs and closing of economic activities like tourism in affected areas and loss of properties. Pakistan has been declared as a terrorist state for several times by the global community. The improvement in the economy due to foreign aid received during the Musharraf regime was for short terms. The reimbursement made to Pakistan was only for meeting the cost of military operations against terrorism. The international financial support was less than half the cost which Pakistan had to pay. The GDP

growth which was higher during the Musharraf regime fell significantly in the PPP regime (2008-13). Expenditure on defense remained high while growth of social sector remained low. Despite of increased expenditure on defense, terrorist activities could not be contained.

International conflicts have been a source of inflow of foreign aid in Pakistan. However, this aid was given in the form of debts while the grants were very low. The aid which was provided to Pakistan by the US for counterterrorism had been used for different military purposes such as for purchasing conventional weapons because there was no distinction between aid for the common purpose like containing terrorism or aid for purchasing military equipment. The US aid had strengthened military's hands in political economy instead of civil institutions.

No doubt that foreign aid rescued the Pakistan's economy, which was stagnating in 1990s. Pakistan's economy showed better performance in the Musharraf's era when the inflow of foreign aid started and sanctions were removed. But the aid could not provide permanent solutions for those problems from which Pakistan was suffering or it could be said that this aid could not improve the economic fundamentals and the slowdown started to re-emerge in the PPP regime (2008-13), in the shape of energy crisis and poor economic outcomes such as low GDP growth rate.

The aid which was received by Pakistan did not affect the lives of a common man. This aid was not for the developmental projects. However, the aid received through Kerry Lugar Bill was for the civilian use but its positive consequences could not be seen.

Government should design a new strategy or review the present strategy of war against terror and they should examine those causes which constrain the success of such a strategy. Soft image should be created before the world through different events which can be attractive for foreign investors. It can be helpful for removing uncertainty. Tourist industry should be promoted and protection should be provided to tourists. Opportunities should be provided to IDPs and youth for enhancing their business and promoting their skills. The heavy cost of war against terrorism should be presented before the world for highlighting that the aid which Pakistan had received was less than half the cost which Pakistan had to pay. When any agreement is signed (for receiving aid) with international community during any global conflict, Government of Pakistan should highlight the problems of their own country like the slow progress of social sector and wide spread poverty. Foreign aid which is received should be dispensed in a transparent manner. The opposition parties and judiciary should hold the government accountable for the foreign aid which they have received.

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