# PAKISTAN

## TRADE SUMMARY

The U.S. trade deficit with Pakistan was $1.7 billion in 2003, an increase of $80 million from 2002. U.S. goods exports in 2003 were $840 million, up 21 percent from the previous year. U.S. imports from Pakistan increased 10 percent in 2003 to reach $2.5 billion. Pakistan currently ranks as the 59th largest export market for U.S. goods. Roughly 72 percent of Pakistani exports to the U.S. consist of textiles and apparel, while U.S. exports to Pakistan are mostly intermediate capital goods. The flow of U.S. foreign direct investment (FDI) to Pakistan in Fiscal 2003 (FY-03, Pakistan's fiscal year ending June 30, 2003) was $211.5 million, down 35 percent from the previous year. This figure contrasts with overall FDI flows to Pakistan, which in fiscal year 2003 jumped 65 percent to $798 million.

## ECONOMIC OVERVIEW

Pakistan's gross domestic product (GDP) grew 5.1 percent during FY 2003, a significant increase from the prior year's 3.5 percent growth rate. Major contributors to GDP growth were services (up 5.3 percent), manufacturing (up 7.7 percent - a 7-year high) and agriculture (up 4.1 percent after two consecutive years of drought induced declines). Consumer inflation remained low at 3.3 percent, credited to improved supplies of essential food items, an appreciating rupee and a decline in interest rates that contributed to lower financing and working capital costs. These factors - in addition to unprecedented growth in worker remittances, improved inflows of foreign assistance and improved export earnings - boosted Pakistan's external account balance as a percentage of GDP to 5.9 percent from 4.8 percent the prior year. Concurrently, foreign exchange reserves rose from $6.3 billion in fiscal year 2002 to $11.1 billion at fiscal year 2003 due to increased flow of remittances through formal banking channels. The debt to GDP ratio dropped to 95.1 percent in FY 2003 from 104.3 percent in FY 2002. The reduction stems from the rupee's appreciation against the U.S. dollar, a write-off of bilateral debt totaling $1 billion by the United States, and retirement of expensive commercial loans.

Reduction of persistent deficit spending has been a crucial element of Pakistan's economic reform program. First under an IMF Standby Arrangement and subsequently under a December 2001 IMF Poverty Reduction and Growth Facility, Pakistan committed to strict deficit reduction targets. Pakistan managed a significant drop in the fiscal deficit to 4.4 percent of GDP in FY 2003 (a 27-year low) compared to the previous year's 6.6 percent on substantial rise in tax revenues, a decline in debt servicing, and below target development expenditures.

Deficit reduction efforts, however, have been constrained by rigidities in spending patterns and a persistently weak tax base (limited to under 1.5 percent of the population). Debt service, which has substantially decreased due to debt forgiveness and reprofiling, consumed approximately 37 percent of government revenues in FY 2003. Defense outlays absorbed an additional 23 percent of revenues, constraining government spending on other priorities, including poverty reduction. Loss-making state-owned enterprises continue to burden the budget, with continued delays in a number of large, proposed energy and financial sector privatizations. Pakistan remains dependent on foreign donors and creditors to finance its social sector and development needs and total public debt is still a significant drag on Pakistan's economic development. Average per capita GDP stands at $492 and 32 percent of the Pakistani population lives below the poverty line.

## IMPORT POLICIES

Since 1998, Pakistan has progressively and substantially reduced tariffs. This effort culminated in June 2002 with the establishment of four maximum import tariff bands of 25 percent, 20 percent, 10 percent and 5 percent. Generally, Pakistan's applied tariffs are below WTO bound commitments, and the weighted average applied tariff is 16.7 percent, down from 56 percent in 1994. The tariff on most

consumer goods was reduced to 25 percent, for most intermediate goods to 10 percent, and for most raw materials to 5 percent. In November 2000, Pakistan reached an agreement with the WTO Balance of Payments Committee to phase out quantitative restrictions on textile imports. The government removed all textile products from its "negative list," including woven cotton fabrics, woven synthetic fabrics, bed linens, curtains, certain knitted fabrics and apparel items, tents, carpets and textile floor coverings. Many of these items are key Pakistani export products. All textile products can now be imported into Pakistan.

Pakistan's trade policy in 2003 continued to ban the import of 30 items, mostly on religious, environmental, security, and health grounds. Imported automobiles continue to face high duties that currently range between 75 percent and 150 percent. The government exempted all domestically produced pharmaceutical-related raw material from its General Sales Tax (GST, actually a value added tax) through a Statutory Regulatory Order issued in April 2002. Imported pharmaceutical-related raw materials subject to a 10 percent customs duty rate are also exempt from payment of GST. This includes most, but not all, imported pharmaceutical raw materials. In the FY 2002 budget the government reduced duties on instant print film and instant print cameras to 10 percent from 30 percent to 200 percent to stem smuggling and to reduce related industry losses.

The government reserves the power to grant sector-specific duty exemptions, concessions, and protections under Statutory Regulatory Orders (SROs). In recent years, the use of SROs has decreased. SROs and other trade policy and regulatory documents are published on the Central Board of Revenue's website, www.cbr.gov.pk.

In January 2000, the government began implementing a transactional valuation system where 99 percent of import valuation is based on invoices, pursuant to the WTO's Customs Valuation Agreement. Currently, about 90 percent of imports are assessed under the WTO-accepted customs valuation system. However, a number of traders in food and non-food consumer products report experiencing irregularities and deviations in the application of the transaction value system.

## STANDARDS TESTING, LABELING AND CERTIFICATION

The Pakistan Standards and Quality Control Authority (PSQCA) is the national standards body. As of June 30, 2003, PSQCA has established over 21,000 standards for agriculture, food, chemicals, civil and mechanical engineering, electronics, weights and measures, and textile products, including 14,500 ISO Standards. Testing facilities for agricultural goods are inadequate and standards are inconsistently applied, resulting in occasional discrimination against U.S. farm products. Generally, however, U.S exporters have not reported problems due to restrictive application of sanitary, phytosanitary or environmental standards. Pakistan accepts most U.S standards.

Pakistan lacks biosafety guidelines for certain bioengineered agricultural goods which has impeded U.S. access. Pakistan's Biosafety Commission has compiled draft biosafety guidelines, but Pakistan's Ministry of Environment has delayed approval of the guidelines for three years.

## GOVERNMENT PROCUREMENT

Pakistan is not a member of the WTO Agreement on Government Procurement and has not made a commitment to begin accession negotiations. Work performed for government agencies, including the purchase of imported equipment and services, is often awarded through tenders that are publicly announced or issued to registered suppliers. The government established the Public Procurement Regulatory Authority in May 2002 to introduce and enforce better procurement practices. International tenders now are publicly advertised and the past practice of sole source contracting using company-specific specifications has been eliminated. There are no buy national policies.

Political influence on procurement decisions, charges of official corruption and long delays in bureaucratic decision-making have been common in the past. Investors have reported instances when the government used the lowest bid as a basis for further negotiations, rather than accepting the lowest bid under its tender rules. Occasionally, the government reportedly has "disqualified" experienced and technically proficient bidders otherwise qualified under tender specifications. The government does not invite private tenders for the transportation of crude oil and requires all transport of crude oil to be conducted by the state-owned Pakistan National Shipping Corporation.

**EXPORT SUBSIDIES**

Pakistan actively promotes the export of Pakistani goods with measures such as tariff concessions on imported inputs and income and sales tax concessions. Subsidies in FY-2003 were confined mostly to wheat and totaled roughly $56 million, according to government budget statistics. The Government established its first Export Processing Zone (EPZ) in Karachi in 1989, with special fiscal and institutional incentives available to encourage the establishment of exclusively export-oriented industries. The Government subsequently established two additional EPZs in Saindak and Risalpur, both in the Punjab. Principal government incentives for EPZ investors include an exemption from all federal, provincial and municipal taxes for production dedicated to exports, exemption from all taxes and duties on equipment, machinery and materials (including components, spare parts and packing material), indefinite loss carry-forward, and access to Export Processing Zone Authority "One Window" services, including facilitated issuance of import permits and export authorizations.

**INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION**

Pakistan's failure to adequately protect intellectual property constitutes one of its most severe barriers to trade and investment. The U.S. government has placed Pakistan on the "Special 301" Watch List every year since 1989 due to widespread piracy, especially of copyrighted materials. In 2002, Pakistan was the fourth largest source of counterfeit and pirated goods seized by the U.S. Customs Service. The vast majority of these goods were media and apparel. Currently, Pakistan does not adequately enforce patents, copyrights, and trademarks due the lack of a central IPR regulatory and enforcement body, an underdeveloped judicial system, and corruption.

In response to longstanding local and international criticism and the need to enforce its WTO TRIPS obligations, the Pakistani Cabinet approved legislation creating the Pakistan Intellectual Property Rights Organization (PIPRO). If enacted by Parliament, PIPRO would consolidate the issuance and enforcement of trademarks, patents, and copyrights in one government body. In addition, the Ministry of Commerce established an IPR Advisory Committee with private sector and NGO participation. Although Pakistan has enacted five major new laws relating to patents, copyrights, trademarks, industrial designs and layout designs for integrated circuits in the past few years, the legislation and/or enforcement mechanisms remain lacking in several areas further described below. Pakistan is a party to the Berne Convention for the

Protection of Literary and Artistic Works, and is a member of the World Intellectual Property Organization (WIPO). The government has expressed an interest in becoming a party to the Paris Convention for the Protection of Industrial Property**.** However, the decision to join this convention likely will be delayed until after the formation of PIPRO. Pakistan has not yet ratified the WIPO Copyright Treaty nor the WIPO Performance and Phonograms Treaty. A draft law concerning plant breeders' rights has been stalled because of a dispute over federal and provincial jurisdiction for the past two years.

**Patents**

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Pakistan enacted a new patent law in 2000 that protects both process patents and product patents in accordance with its WTO obligations. Under this law both the patent-owner and licensees can file suit against those who infringe. Unfortunately, the 2002 Patent Ordinance weakened the 2000 Patent Law by eliminating use patents, restricting patent filings to single chemical entities, limiting protection for derivatives, introducing barriers to patenting biotechnology-based inventions and establishing a mechanism for compulsory licensing. This last provision has aroused great concern among pharmaceutical firms desiring to sell patented drugs in Pakistan. First, Pakistan fails to protect data exclusivity during the licensing process. Secondly, the government has granted licenses to sell pharmaceuticals without checking whether another firm holds an active patent on that compound. Although courts have issued injunction orders against firms licensed by the Ministry of Health, which sell drugs in violation of patent holder rights, such orders are not consistently enforced. Patent theft is exacerbated by the 12 months to 24 months often required for registration in Pakistan of drugs available on the world market. During this registration process, the government also sets prices - often at a level that does not reflect the cost of developing the product.

**Trademarks**

Pakistan developed its Trademarks Ordinance in 2000, which provides for registration and better protection of trademarks and for prevention of the use of fraudulent marks. Nonetheless, the ordinance is awaiting enactment, pending finalization after consideration of public comments. The comment period closed in October 2003 and enactment is expected by early 2004. The government has eliminated the requirement that pharmaceutical firms label the generic name on all products with at least equal prominence as that of the brand name. Trademark infringement remains widespread.

**Copyrights**

According to the International Intellectual Property Association, calendar year 2003 copyright piracy rates in Pakistan stood at 95 percent for motion pictures and100 percent for records and music (no figures were available for business and entertainment software). CD and DVD losses were estimated at $82 million. Pakistan has aroused widespread concern by becoming a major exporter of pirated optical disks. Industry groups estimate that eight firms produced roughly 180 million illegal disks in 2003, up nearly 275 percent over 2002 levels. Industry watchers believe that almost 90 percent of this production is exported.

This level of piracy occurs despite the current ban on the import and export of pirated materials. The law includes a maximum punishment of three years imprisonment and a fine of 100,000 rupees ($1,750). Enforcement, however, remains weak, characterized by sporadic raids at the retail level, few prosecutions, and anemic penalties (no separate IPR enforcement bodies or IPR courts exist in Pakistan). Authorities have not inspected optical disk factories operating in Pakistan.

## SERVICES BARRIERS

Pakistan generally permits foreign investment in services, subject to provisions including a minimum initial capital investment of $300,000. Foreign investors may hold up to a 100 percent equity stake at the outset. However, repatriation of profits is restricted to a maximum of 60 percent of total equity or profits, and 40 percent of equity must be held by Pakistani investors within five years of the initial investment. Foreign investments not meeting these requirements are still permitted, but are not guaranteed repatriation of profits.

Investment policy also allows foreign investors in services and other non-manufacturing sectors (including international food franchises) to remit technical fees and royalties, although conditions apply. In information technology services, including software development, foreign investors may hold a 100 percent equity stake. Investors in this field are not subject to the requirements for minimum initial investment and 40 percent Pakistani equity within five years.

**Telecommunications**

In telecommunications, the government permits 100 percent foreign equity with a minimum foreign equity investment of $300,000 in specific services, including electronic information services, card-pay telephone services, paging services, and voice mail services. Competition among service providers is already allowed in cellular telephony. In July 2003, the government announced a telecommunications sector deregulation policy in compliance with its WTO commitments. When implemented, this policy will end the exclusive right of the majority state-owned Pakistan Telecommunication Company Limited (PTCL) to provide basic telephone services and will allow cross-border market access for voice services. Pakistan currently allows the cross-border provision of packet-switched data and Internet services. Roughly 50 private firms, including foreign investors, provide Internet services on competitive networks. At present, the government does not issue exclusive licenses for voice-over-internet providers (VOIP). Long distance telephone license holders can also provide VOIP services.

The Government of Pakistan prohibits the importation of films that are deemed inconsistent with local religious and cultural standards. Films from neighboring India are routinely denied entry via cable transmission or video/digital media, but are widely available in pirated form.

Pakistan improved its financial services commitments in the WTO Financial Services Agreement in December 1997. These commitments grant the right to establish new banks, as well as grandfathering acquired rights of established foreign banks and foreign securities firms. The State Bank of Pakistan (SBP, Pakistan's central bank) has changed its branch licensing policy and has eliminated restrictions on the number of branches for foreign banks. Currently foreign banks, like local banks, have to submit an annual branch expansion plan to the SBP for approval. The SBP approves new branch openings based on the bank's net worth, adequacy of its capital structure, future earning prospects, credit disciplines, and the needs of the local population. Foreign brokers, like their Pakistani counterparts, must register with the Securities and Exchange Commission of Pakistan.

The government has opened the insurance market as one of its financial sector reforms. Foreign investors are allowed to hold a 100 percent equity (subject to the requirement to establish 40 percent Pakistani equity in 5 years) share of companies operating in the life and general insurance sectors. They are, however, required to bring in a minimum of $2 million in foreign capital and raise an equal amount in equity in the local market. There are no restrictions on the repatriation of profits, and capital investment made in this sector can be repatriated with the permission of the SBP. Pakistan does not regulate insurance premiums. The government issued a new insurance law in 2000, raising capital adequacy standards and enhancing policyholder protections.

The government permits only parastatal National Insurance Company to underwrite and insure public sector firms. Private sector firms must use state-owned Pakistan Reinsurance Company for a minimum of 10 percent of their reinsurance requirements through 2004. Market domination in this sector may pose a substantial barrier to entry. State-owned State Life Insurance holds over 80 percent of the market in life insurance, while five major companies account for 78 percent of the market share in general insurance.

Foreign professionals can provide legal and engineering consultancy services - as opposed to direct services - subject to the $300,000 minimum capital and 40 percent/five year local equity requirements. A

legal consultant need not be licensed to practice law in Pakistan. However, foreign lawyers may not appear in court or otherwise formally plead cases, even if they work with local lawyers, unless licensed. The Islamabad-based Pakistan Bar Council licenses attorneys in Pakistan, and no *de jure* prohibition exists against the admission of foreign lawyers into the bar. Similarly, foreign doctors must register with the Pakistan Medical and Dental Council, and foreign engineers are required to register with the Pakistan Engineering Council in order to practice their respective professions in Pakistan.

**INVESTMENT BARRIERS**

Foreign investors are free to establish and own business enterprises in all sectors of the economy with the exception of four restricted areas: arms and munitions, high explosives, currency/mint operations, and radioactive substances. The government's investment policy promises full repatriation of capital, capital gains, dividends, and profits with the approval of the State Bank of Pakistan. No restrictions exist on technology transfer. The law provides for expropriations only upon adequate compensation and prohibits changes in benefits and incentives for the purpose of disadvantaging foreign investors.

Pakistan has granted significant tax and duty incentives to two categories of industries. "Priority industries" include tourism, housing and construction. "Value added export industries" include manufacturing categories such as garments, bed linens, surgical instruments, and sporting goods. For "priority industries," Pakistan has reduced the maximum customs duty from 25 percent to 10 percent on imported plant, machinery and equipment. The government removed minimum equity investment and national ownership requirements for investments in this category, and granted a 50 percent depreciation allowance to all fixed assets. "Value-added export industries" enjoy higher incentive levels, including zero duties on imported plant, machinery and equipment, in addition to a first-year depreciation allowance of 50% on all fixed assets. Nonetheless, Pakistan subjects all export industries that receive any incentives (as opposed solely to "value added export industries") to performance requirements. Those obligations include the requirement to export an average of 50 percent of production during the first 10 years of operation. Any exporter achieving 10 percent export growth over the prior year is permitted to retain 50 percent of increased export earnings in foreign exchange to purchase machinery, raw material, and promotional services.

The government of Pakistan has substantially complied with its WTO Trade Related Investment Measures (TRIMS) commitments concerning local content rules. In 1999, Pakistan's deletion program (mandating the use of domestic inputs) encompassed 106 items. As of December 2003, 16 items in the auto and motorcycle industries remain. Concerning these 16 items, Pakistan has petitioned for a three-year extension on its original December 31, 2003 deadline to eliminate all deletions.

Although Pakistan has enacted a Monopolies and Restrictive Trade Practices Ordinance, and established a Monopoly Control Authority, parastatal firms are exempt from the provisions of this law and regulatory oversight appears to suffer from capacity limitations. Thus, in the Pakistani market, where state-owned firms dominate several sectors, competition policy remains incomplete. State-owned Water and Power Development Agency (WAPDA) and Karachi Electric Supply Corporation (KESC) retain control of power transmission and distribution. In telecoms, Pakistan Telecommunications Company Limited (PTCL) retains exclusive control over land lines and switching. Two private airlines compete with state-owned Pakistan International Airlines and the government permits them to fly choice trunk routes and to undercut PIA on fares. In retail food sales, the government has used pricing in its several hundred-unit Utility Stores Corporation chain to influence prices of essential foodstuffs. Market leaders in the cement and sugar industries are alleged to have formed cartels.

**ELECTRONIC COMMERCE**

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Although there are no trade restrictions on electronic commerce, the government blocks certain websites that it deems as conflicting with Pakistani religious and cultural norms. Electronic commerce is, however, not well-developed in Pakistan. In 2002, the government enacted an Electronic Transactions Ordinance that adopted international standards and provided for the establishment of a certification authority. The Ordinance has not yet been implemented. There are no duties and taxes on electronic commerce in Pakistan.

## OTHER BARRIERS

Businesses operating in Pakistan have repeatedly called for the strengthening of law and order. Corruption and a weak judicial system remain recurrent and substantial disincentives to investment. Pakistani laws targeting the fight against corruption include the 1947 Prevention of Corruption Act, the 1973 Efficiency and Discipline Rules and, most recently, the 1999 National Accountability (NAB) Ordinance. Previously, the NAB, the Federal Investigation Agency (FIA), and Provincial Anti-Corruption Departments shared official responsibility for combating corruption. In October 2002, Pakistan's cabinet approved a National Anti-Corruption Strategy (NACS) that identified areas of pervasive corruption and recommended time-bound measures and reforms to combat corruption. The NACS also named the NAB as the sole anticorruption agency at the federal level. Contract enforcement is difficult in Pakistan. Pakistan is not a member of the New York Convention on Foreign Arbitral Awards. Pakistan's ranking in Transparency International's Corruption Perceptions Index changed from 77 out of 102 countries in 2002 to 92 out of 133 countries listed in 2003.