PAKISTAN

TRADE SUMMARY

In 2001, the U.S. trade deficit with Pakistan was $1.7 billion, an increase of $3 million over the previous year. U.S. goods exports to Pakistan were $542 million in 2001, an increase of $80 million (17.3 percent) over 2000. Pakistan ranked as the 65th largest U.S. trading partner in 2001. U.S. imports from Pakistan totaled $2.2 billion in 2001, an increase of $83 million (3.8 percent) over 2000. The stock of U.S. foreign direct investment in Pakistan increased by 3.2 percent in 2000 to $515 million.

OVERVIEW

During its 2001 fiscal year (ending June 30, 2001), Pakistan's economy recorded a growth rate of only 2.7 percent, a decrease compared to growth of 3.9 percent recorded the previous year. The lower growth rate was due to poor performance of the agriculture sector. Large-scale manufacturing saved the economy from total stagnation by registering a growth rate of 8.4 percent, up from 0.2 percent the previous year. A combination of domestic and external shocks kept the economy under stress; these shocks included persistent drought conditions and a rise in world oil prices. The economy also labored under the short-run negative effects of policy changes introduced to address underlying structural problems. A slowdown in the informal economy and cuts in public spending over the last few years have reduced opportunities for economic expansion and employment generation. The military government's economic agenda, which is based on accountability, improved governance, and a broadening of the tax base, created major structural shifts in the economy, resulting in substantial transitional costs. However, these structural measures should lay the foundations for sustainable growth in the future.

Pakistan's decision to support the international coalition against terrorism and its frontline status has further exposed the country to economic shocks which may reduce GDP growth again in the current fiscal year. Another cause for concern is the 1999 Pakistan Supreme Court ruling ordering the Pakistani Government to implement an interest-free economy by June 30, 2002, the end of the current fiscal year. The Pakistani Government has established several commissions to develop the ways and means to carry out this decision. In December 2001, the Government of Pakistan authorized the establishment of separate Islamic banks to operate as a parallel banking system. It is not yet known if this will satisfy the court as a substitute for transforming the entire banking system.

The Pakistani Government has made economic revival and poverty alleviation its top priority. Its stated goals are restoring investor confidence through stability and consistency in economic policies, increasing domestic savings, reforming the tax system, restructuring and privatizing state-owned enterprises, boosting agriculture and reviving industry, including information technology. The Government of Pakistan seeks to promote exports and reduce imports, especially through increased agricultural production of wheat and edible oils. The Government of Pakistan targeted the oil and gas sector for further development and increased foreign investment, offering liberal incentives for exploration. It has taken steps to privatize several major government entities in this sector. The Government of Pakistan is also attempting to address widespread corruption throughout the economy. Over the last two years, progress has been made on laying the groundwork for structural reforms, but success will depend on Pakistan's ability to implement them. To date, Pakistani Government has been able to make significant progress in tax documentation through an extensive business and residential tax survey. However, it has not fully met expectations in using that information to generate significant increases in revenue.

Pakistan faces a challenging balance-of-payments situation with a current account deficit of 1.8 percent of GDP in 2001. Pakistan completed its stand-by arrangement with the IMF, fulfilling all of the program targets with the exception of tax revenue target collection. In December 2001, the Government of Pakistan concluded the negotiation of a $1.3 billion Poverty Reduction and Growth Facility (PRGF) program with the IMF. This program signals the Government of Pakistan's intention to continue with the comprehensive structural adjustment process initiated two years ago. It also helped to facilitate further debt rescheduling through the Paris Club that will significantly lessen the burden of over $4.7 billion in loan payments due in 2002. After September 11, many countries, including the United States, extended bilateral assistance to Pakistan, which increased net foreign exchange reserve holdings to almost $3 billion by the end of 2001.

IMPORT POLICIES

The Pakistani Government has committed itself to further liberalize its trade regime as presented in its IMF/World Bank policy framework paper of December 1998. Consistent with this commitment, on June 31, 2001, the maximum import tariff was reduced from 35 percent to 30 percent. The Government of Pakistan established four tariff categories with duty rates of 30 percent, 20 percent, 10 percent, and 5 percent. The tariff on most consumer goods was reduced to 30 percent, for most intermediate goods to 20 percent, and for most raw materials to 5 percent. The Government of Pakistan has also committed itself to reduce further the maximum import tariff to 25 percent by June 2002. It has done away with most quantitative restrictions on imports. Commercial banks imposed cash margin requirements on imports for a temporary period to stop a free fall of the rupee after the Government of Pakistan decided to float the exchange rate on July 20, 2000. The cash-margin requirements have now been withdrawn. In November 2000, following a delay of several years, Pakistan reached an agreement with the WTO Balance of Payments Committee to phase out quantitative restrictions on textile imports. The Government of Pakistan recently 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. However, Pakistan's trade policy in 2001 continues to ban the import of 30 items, mostly on religious, environmental, security and health grounds.

Pakistan has continued certain detrimental import restrictions, mostly questionable fees and preferential tariff rates. Pharmaceutical-related raw materials and soda ash continue to suffer from these barriers. U.S. industries have expressed particular concern with the Government of Pakistan's discriminatory application of the internal sales tax between some imported pharmaceutical raw materials (taxed at 15 percent) and the same domestically produced raw materials (exempt from taxation). However, the imported pharmaceutical raw materials that are subject to 10 percent or less custom duty are exempt from sales tax. The industry believes that Pakistan's imposition of price controls on pharmaceutical end products further impedes U.S. pharmaceutical manufacturers from maintaining profitability. The industry has estimated that removal of these barriers would result in increased sales of U.S. pharmaceutical companies' products of $50-100 million.

The Pakistani tariff regime is generally characterized by complexity, broad bureaucratic discretionary powers, and very limited transparency. Administrative decisions frequently grant exemptions and concessions from general rules under Special Regulatory Orders (SRO) that amount to temporary duty suspension decrees. As a result, different rates are applied to the same product and average applied rates are sometimes lower than statutory duties. The international financial institution reform programs address these problems. Simplifying the tariff regime will benefit U.S. exporters. The new Pakistani Government has also spoken out generally against the prior Administration's abuse of the SRO authority. Other U.S. exports that continue to face market access restrictions include instant print film and instant print cameras. These products face high import duties, ranging between 30 and 200 percent, resulting in their smuggling into Pakistan. U.S. film and entertainment industry representatives have estimated an annual loss of approximately $1 million due to the entertainment taxes.

Pakistan's applied tariffs on 91 eight-digit HS items (mostly textiles and apparel) exceed their WTO tariff binding levels by up to 17 percentage points. Reportedly the Pakistan authorities are aware of this breach in their WTO commitment and have taken steps to address it in their next budget.

Customs Barriers

The Government of Pakistan canceled its controversial pre-shipment inspection valuation system in March 1997. In January 2000, it began implementing a transactional valuation system where 99 percent of import valuation is based on invoices pursuant to the WTO's Customs Valuation Agreement. At the same time, it applied for a minimum value waiver for customs valuation for some products. Currently about 85 percent of imports are assessed under the WTO-accepted customs valuation system. Many of those products identified for minimum value treatment are key Pakistani export products, including textiles. Investors and importers complain that the Pakistani Government incentives advertised at the policy level are not actually granted by customs officials at the time of import.

STANDARDS, TESTING, LABELING AND CERTIFICATION

The Pakistan Standards and Quality Control Authority (PSQCA) is the national standards body. PSQCA has so far established about 4,600 national standards for agriculture and food, chemicals, civil and mechanical engineering, electronics, weights and measures and textile products. Pakistan's barriers to trade often are expressed as extra fees. Less frequently, usually in the context of protecting some domestically manufactured product, the U.S. exporter will encounter difficulty with "quality" standards. Testing facilities for agricultural goods are inadequate, and standards are inconsistently applied, resulting in occasional discrimination against U.S. farm products.

GOVERNMENT PROCUREMENT

Pakistan is not a member of the WTO Agreement on Government Procurement. Work performed for government agencies, including purchase of imported equipment and services, often is awarded through tenders that are publicly announced or issued to registered suppliers. The Government of Pakistan nominally subscribes to principles of international competitive bidding. Political influence on procurement decisions, charges of official corruption, and long delays in bureaucratic decision-making have been common in the past. Industry estimates that if these barriers are fully eliminated, U.S. exports would increase by $10-25 million. The sanctity of contracts has also been an issue for some companies dealing with the past government although the resolution of a contract dispute with a major private power company (Hubco) sends a positive signal to potential investors in Pakistan. The new government has placed a high priority on good governance and rooting out corruption, and has established an office for procurement reform in an attempt to introduce and enforce better procurement practices in Pakistan. However, no big infrastructure projects have been tendered to test the new government's better procurement practices commitment. The government intends that international tenders will be properly advertised and that the past practice of sole-source contracting by means of company-specific specifications will no longer be practiced.

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. The Government of Pakistan has withdrawn the subsidy on export finance as part of its commitment with the IMF in its most recent trade policy. Pakistan has established export processing zones with benefits including tax holidays, exemption of imports from taxes and duties, and exemption from labor laws and various other regulatory regimes. Incentives for exports appear to be available to both foreign and domestic investors. In 2001, the Pakistani Government provided a subsidy of close to $1 million on the export of wheat. The Pakistani Government also subsidized the export of cotton through the trading corporation of Pakistan during 2001, estimated to be worth $2 million. The freight subsidy for exports of fruits and vegetables provided during 2000 was discontinued in 2001.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

The laws in Pakistan generally provide for protection of intellectual property rights. Pakistan is a Member of the World Trade Organization and enacted five major new laws relating to patents, copyrights, trademarks, industrial designs and layout designs for integrated circuits during 2000 in an attempt to bring these areas into compliance with the Agreement on Trade-related Aspects of Intellectual Property Rights (TRIPS). A new law on plant breeders' rights has been drafted and is awaiting approval. Pakistan is a party to the Berne Convention for the Protection of Literary and Artistic Works, the Universal Copyright Convention, and is a member of the World Intellectual Property Organization. It is not a party to the Paris Convention for the Protection of Industrial Property. The Pakistani Government has, however, made a formal decision to join the Paris Convention and is in the process of bringing laws into compliance with the requirements of the Convention.

Pakistan has been on the "Special 301" watch list since 1989 due to widespread piracy, especially of copyrighted materials. Senior government officials are aware of the negative impact of intellectual property rights violations on Pakistan's investment climate. The Pakistani Government realizes the need to provide better protection for intellectual property rights, due to Pakistan's desire to grow and protect its nascent information technology industry and has improved and enacted laws relating to copyrights, trademarks, patents, industrial designs and layout designs for integrated circuits. The new copyright law, for example, considerably increases fines for copyright infringement and also provides for imprisonment as a penalty. However, there are remaining deficiencies in the copyright legal regime with

respect to the lack of availability of civil and criminal *ex parte* search procedures.
Pakistan has recently enacted a new patent law that protects both process patents and product patents in accordance with its WTO obligations. In addition, under this law both the patent owner and licensees can file suit against those who infringe. However, backlogged cases in the courts could result in delays in issuing injunction orders against violators. U.S. industry reports that piracy continues to inflict losses on the research-based pharmaceutical industry at an estimated cost of $15-20 million per year.

Trademarks

Pakistan enacted a new trademarks ordinance, which provides for registration and better protection of trademarks and for prevention of the use of fraudulent marks. Pakistan has done away with the previous requirement that pharmaceutical firms label the generic name on all products with at least equal prominence as that of the brand name. There have, however, been occasional instances of trademark infringement, involving a range of products such as toys, playing cards, and industrial machinery. U.S. industry estimates a loss of $5-10 million in U.S. exports for patent and trademark violations.

Copyrights

Violations of intellectual property rights in Pakistan are most common in the area of copyrights, where the piracy levels are exceptionally high. The market for imported computer software has remained nearly 80-percent pirated until recently (multinational firms and other international agencies are the only users of genuine software), while U.S. industry has estimated that the piracy rate for videos has declined to around 60 percent. The most troubling development is the growth of optical media piracy. Industry estimates a 90 percent piracy rate for optical discs, stemming from the rapid growth of illegal production plants. Industry estimates that as many as eight optical media plants have opened in Pakistan since 1999, with a production capacity of 150 million units. Illegal CDs from these plants have inundated the local market and been found for sale in the Middle East and South Asia.

The Pakistani Government has recognized the need for better protection of software in order to establish a Pakistani information technology industry, promote industry standards, and encourage electronic commerce. The new amended copyright law bans the import and export of pirated copies. The law also provides for punishment of violators with up to three years imprisonment and a fine of up to 100,000 rupees ($1,695). Despite moderate improvements to law enforcement efforts, U.S. industry continues to express concern over the high rate of video piracy in the form of back-to-back copying of videos in video outlets. Furthermore, the entertainment industry reports that motion picture infringement cases move slowly through the court system due to case backlog. Piracy of copyrighted textile designs and reprint piracy of books (especially computer books, business titles, and medical texts) continue to be significant problems. The new copyright law may not address sufficiently protections for literary works.

Despite improvements in enforcement, the courts have been lax regarding successful prosecution of copyright infringement. In the area of copyright infringement alone, the International Intellectual Property Alliance estimates that in Pakistan, the piracy of films, sound recordings, computer programs, and books resulted in trade losses of $155.6 million in 2000, slightly more than double the total losses for 1999.

SERVICE BARRIERS

In 2000, the Government of Pakistan extended an investment liberalization policy started in 1997 by reducing areas of bureaucratic discretion and offering more tax and other incentives in the infrastructure, services and agriculture sectors. The modified investment policy, for example, places tourism, housing and construction in the category of "priority industries," meaning that they pay only a 10 percent-custom duty (as compared to the maximum tariff rate of 30 percent) on imported plant, machinery and equipment, and receive significant first-year tax relief for the cost of machinery. In addition, there is no minimum amount of equity investment, and investors in these sectors may hold 100-percent foreign equity. The policy also allows services and other non-manufacturing sectors (including international food franchises) to remit technical fees and royalties, although there are several conditions. In the agriculture and infrastructure sectors, the recent changes increased fiscal relief in the first year allowance from 50 percent to 75 percent of the machinery cost.

The policy now also provides for a comprehensive list of value-added industries, which are entitled to the highest level of incentives. These include no duty on imported plant, machinery or equipment and a first year fiscal allowance of 90 percent of the cost of machinery. The modified policy now allows investors to invest in any activity falling under the services sector. In general, investment in services is permitted under the modified policy where the amount of foreign equity investment is at least $300,000. Foreign investors are allowed to hold up to 100-percent equity at the outset subject to the condition that repatriation of profits will be restricted to a maximum of 60 percent of total equity or profits. The policy also requires that 40 percent of equity 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. Information technology services, including software development, however, have been defined as an "industry" by the investment policy, which means that foreign investors are allowed participation on the basis of 100 percent foreign equity, and are neither subject to a minimum investment requirement nor are required to have 40 percent Pakistani equity within five years.

There is a specific list of deregulated telecommunication services, including electronic information services, card-pay telephone services, paging services and voice mail services. The investment policy permits 100 percent foreign equity on a repatriable basis as long as foreign equity investment is at least $300,000. Basic telephony remains the monopoly of the majority state-owned Pakistan Telecommunications Corporation until 2005, but competition among service providers is now allowed in cellular telephony. In WTO negotiations on basic telecommunications, Pakistan made commitments on basic telecommunications services, with a phase-in on some obligations. For example, Pakistan has agreed to provide cross-border market access for voice services as of January 1, 2005, and will allow the cross-border provision of packet-switched data and Internet services on competitive networks by 2004. As part of the agreement, Pakistan also adopted certain pro-competitive regulatory principles.

Pakistan improved its financial services commitments in the WTO financial services negotiations in December 1997. These commitments promise some liberalization by granting the right of establishment for banks, as well as grandfathering acquired rights of foreign banks and foreign securities firms. The State Bank of Pakistan has changed its branch licensing policy and has done away with the restrictions on the number of branches for foreign banks. Now foreign banks like local banks have to submit an annual branch expansion plan to the state bank for approval. The State Bank approves opening of a branch based on the bank's net worth, adequacy of its capital structure, future earning prospects, credit disciplines and needs of population of an area where the branch is to be opened. Foreign banks, however, are subject to ceilings on lending to state-owned corporations. Although these ceilings (called "public sector ceilings") also apply to local banks, they are decided by the State Bank of Pakistan and are discretionary in nature and, thus, could be discriminatory. Foreign brokers, like their Pakistani counterparts, have to register with the Securities and Exchange Commission of Pakistan and maintain margin and capital adequacy requirements.

The few foreign insurance companies operating in Pakistan have faced various tax problems, long delays in remitting profits, and problems associated with operating within the insurance cartel. The new government has opened the insurance market as one of its reforms of the financial sector. Foreign investors are allowed to hold 51 percent shares of companies operating in the life and general insurance sectors. They, however, are required to bring in the minimum amount of $2.0 million in foreign exchange and raise an equal amount in equity in the local market. There are no restrictions on the repatriation of profits but the capital investment made in these sectors cannot be repatriated. The Pakistani Government also issued a new insurance law in 2000 that strengthens the insurance market by raising financial requirements and offers better protection to policyholders. The weak insurance companies were already under the threat of being wiped out under this ordinance but recent developments in the insurance sector, such as the rise in reinsurance premiums post-September 11 have accelerated this process. In view of this situation, Pakistan's insurance sector is expected to undergo a large scale restructuring through mergers, acquisitions and closures.

Video piracy, along with rapid growth in cable operations, has reduced the demand for movies shown in theaters making it very difficult for theaters to be profitable. Theater owners cannot set admission prices independently but have to take into account the consent of the excise and taxation department.

Legal Services

A person can provide legal consultancy services on foreign and international law without being licensed to practice law in Pakistan. Unless they are licensed in Pakistan, however, foreign lawyers may not appear in court or otherwise formally plead cases, even if they work with local lawyers (Islamabad-based Pakistan Bar Council issues licenses for practicing law in Pakistan). Foreign lawyers have to make a minimum investment of $300,000 and are required to have 40 percent Pakistani equity within five years of initial investment if they want to form law firms in Pakistan.

INVESTMENT BARRIERS

As mentioned above, the new investment policy of November 1997 promised liberalization of the climate for foreign direct investment. Foreign investors are allowed to invest in the manufacturing and industrial sectors on the basis of 100-percent foreign equity without government permission. (Several sectors, such as explosives, radioactive substances or alcohol manufacturing, are exempt for security or religious reasons.) The investment policy promises full repatriation of capital, capital gains, dividends, and profits with the approval of the State Bank of Pakistan; no restrictions on transfer of technology; expropriations only upon adequate compensation; and no changes in benefits and incentives to the disadvantage of investors.

Investors often face unstable policy conditions, however, particularly on large infrastructure projects. For example, the previous government's consistent harassment of and refusal to recognize its contractual commitments to the independent power producers severely damaged Pakistan's attractiveness to foreign investors. The current government, however, has resolved all outstanding issues with the independent power producers, which may improve the climate for investment. In the past, changes in governments have led to significant alterations in the conditions and assumptions under which an investment agreement had been signed or was being pursued.

Trade-related Investment Measures

In 1995, Pakistan identified measures inconsistent with its obligations under the WTO agreement on Trade-related Investment Measures (TRIMS). These measures are local content requirements in the automobile, electronics, electrical products, and engineering industries under Pakistan's "deletion program." The program is ostensibly not compulsory, but at least one telecommunications equipment producer has reported that telecommunications licensees must adhere to the import-deletion program. Investors who "voluntarily" undertake to increase the local content of their output enjoy lower tariffs on imported inputs but are subject to fines for non-compliance with an agreed-upon import deletion schedule. Pakistan Engineering Board's Indigenization Committee decides in consultation with concerned industries the local content levels depending on the availability of spare parts in the country. Proper notification allowed developing-country WTO members to maintain such measures for a five-year transition period, ending January 1, 2000. In December 1999, Pakistan submitted a request to the WTO for a lengthy, seven-year extension to its transition period. The WTO had granted an extension of two years from January 1, 2000 to December 31, 2001 to several countries, including Pakistan and asked Pakistan and the other countries receiving extensions to submit a phase-out plan for local content requirements as part of the requirements for further extensions not to exceed two years. Pakistan submitted a phase-out plan for all industries covered by the deletion program and received a further extension of two years from December 2001 to December 2003.

OTHER BARRIERS

Lack of transparency is a recurrent and substantial problem in many areas, including government procurement and customs valuation. Two Pakistani federal government bodies take an interest in this problem, in addition to various government departments that might investigate allegations of corruption under their purview. The new military government has targeted corruption as one of its highest priorities, creating a National Accountability Bureau (NAB) and promulgating a strict accountability ordinance aimed at rooting out corruption committed by prior government officials and politicians, tax evaders and fraudulent loan defaulters. A number of prominent persons have been arrested, with more arrests promised in the future. This accountability campaign has not been able to restore funds on a significant scale, however. There has been a decrease in corruption at the top level, although there have been no big infrastructure projects under the new government to test its resolve. Lower-level corruption remains endemic.