PAKISTAN

TRADE SUMMARY

The U.S. trade deficit with Pakistan was $1.6 billion in 2002, a decrease of $97 million from $1.7 billion in 2001. U.S. goods exports in 2002 were $694 million, up 28.2 percent from the previous year. Corresponding U.S. imports from Pakistan were $2.3 billion, up 2.5 percent. Pakistan is currently the 59th largest export market for U.S. goods.

The stock of U.S. foreign direct investment (FDI) in Pakistan in 2001 was $474 million, the same as in 2000.

Economic Overview

Pakistan's real Gross Domestic Product (GDP) grew 3.6 percent during FY 2002, a significant increase from the prior year's 2.7 percent growth rate. Major contributors to GDP growth were services (up 5.2 percent) and manufacturing (up 4.4 percent). The agricultural sector recovered from a drought-induced 2.5 percent decline the prior year to increase by 1.4 percent. Inflation, at 2.7 percent, was the lowest in three decades. Pakistan's external account, as a percentage of GDP, increased to 2.5 percent from 0.09 percent the prior year, largely due to a post-September 11 drop in imports and a significant increase in remittances through official channels. Improved inflows of foreign economic assistance along with increased remittances helped build foreign exchange reserves from $2.6 billion in fiscal year 2001 to $5.5 billion in fiscal year 2002, helping stabilize the value of the rupee.

Structural Policies

Pakistan's economic performance has been handicapped in recent years by ineffective governance and weak policy implementation. The Government of Pakistan has made economic revival a main priority and its stated goals include restoring investor confidence through stability and consistency in economic policies, increasing domestic savings, tax reform, restructuring and privatizing state enterprises, boosting agriculture, and reviving industry. In consultation with the International Monetary Fund (IMF), World Bank, and Asian Development Bank, Pakistan is implementing broad-based structural reforms aimed at achieving sustainable growth. These include reducing the fiscal deficit by broadening the tax base and controlling expenditures; reducing the current account deficit through increased exports and following a market-based exchange rate system; containing inflation by limiting government borrowing from the banking sector; and deregulating and increasing the role of the private sector through privatization of major state-owned enterprises. Pakistan has also been pursuing a long-term strategy of market liberalization, reducing the government's direct intervention, and opening the economy to international competition. Over the past three years, the Government of Pakistan has succeeded in achieving a degree of macro-economic stability. The ability of the new government to sustain this effort will be an important factor in attracting needed investment.

Budget Constraints

A central element of Pakistan's economic reform measures has been an effort to reduce persistent deficit spending by increasing revenues and controlling expenditures. First, under an IMF Standby Arrangement and, beginning in December, 2001 under an IMF Poverty Reduction & Growth Facility, Pakistan committed to strict deficit reduction targets. However, a significant drop in the fiscal deficit from 6.5 percent of GDP in FY 2000 to 5.3 percent of GDP in FY 2001 was not sustained. The FY 2002 deficit jumped to 7 percent of GDP due to increased defense expenditures and large equity injections into loss-producing public sector enterprises. The aftermath of September 11 also undermined government revenue collection efforts, with customs revenues down on significantly decreased imports.

Deficit reduction efforts have been constrained by rigidities in spending patterns and a weak tax base. Debt service absorbed approximately 41 percent of government revenues (excluding grants) in FY 2002. Defense outlays absorbed an additional 24 percent of revenues, constraining government spending on other priorities, including poverty reduction. The government has made compliance with the tax regime, including a 15 percent value added tax, a keystone of its economic reform program. Only limited progress has been made, however, in expanding the country's narrow tax base and less than 1 percent of Pakistanis currently pay income tax. The government financed its fiscal deficit through bank borrowings, the sale of short-term treasury bills and long-term Pakistan Investment Bonds, as well as through grants from donor nations and borrowing from multilateral institutions.

Debt Burden

Pakistan remains dependent on foreign donors and creditors to finance its balance of payments deficit. The government successfully completed a Standby Arrangement with the IMF in 2001 and has graduated into a multi-year Poverty Reduction and Growth Facility. Partially as a result of its successful performance under these programs, Pakistan was able to conclude a December 2001 agreement with its official Paris Club creditors to re-profile $12.5 billion in debt stock under favorable terms. This agreement significantly reduced the net present value of Pakistan's external debt service burden.

An unsustainable buildup of external liabilities and debt service payments in the 1990s increasingly appropriated resources away from Pakistan's development goals. The nation's debt burden and social indicators deteriorated through the decade. At the end of FY 01, Pakistan's total domestic and external debt burden peaked at over 100 percent of GDP. A formal debt-exit strategy has been launched by the government, key elements of which include strong fiscal adjustment, strong financial support on concessional terms from the International Financial Institutions, the use of privatization proceeds to pay down existing debt, debt re-profiling through the Paris Club and debt forgiveness from bilateral official creditors. While prudent government policy, the December 2001 Paris Club agreement, and post-September 11 bilateral creditor debt forgiveness have all helped decrease Pakistan's debt burden, total public debt remains a significant drag on Pakistan's economic development.

IMPORT POLICIES

The Pakistani Government has committed itself to liberalize further its trade regime as presented in its IMF/World Bank Policy framework paper of December 1998. Consistent with this commitment, on June 30, 2002, the maximum import tariff was reduced from 30 percent to 25 percent. The government established three tariff categories with duty rates of 25 percent, 15 percent, and 5 percent. 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, 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 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 2002 continued to ban the import of 30 items, mostly on religious, environmental, security, and health grounds. Automobiles continue to face high duties ranging between 80 percent and 200 percent.

In an effort to eliminate the discriminatory application of internal sales taxes on pharmaceutical–related raw materials, the Government of Pakistan raised the tax on domestically produced raw materials to 15 percent, equaling the tax levied on like imported items. Previously these locally produced items were tax exempt.

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 Statutory Regulatory Orders 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. International financial institution-supported tariff reform programs address these problems. Simplifying the tariff regime will benefit U.S. exporters. For example, 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.

Customs Barriers

The government canceled its controversial pre-shipment inspection valuation system in March 1997. 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. At the same time, the government applied for a minimum value waiver for customs valuation for some products. Currently, however, about 85 percent of imports are assessed under the WTO-accepted customs valuation system. Investors and importers complain that the 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. As of June 30, 2002, PSQCA established over 15,000 standards for agriculture, food, chemicals, civil and mechanical engineering, electronics, weights and measures, and textile products, including 13,500 ISO Standards. Pakistan's barriers to trade are often expressed as extra fees. Less frequently, usually in the context of protecting some domestically manufactured product, U.S. exporters 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. Pakistan does not support beginning negotiations on a proposed WTO agreement on transparency in government procurement. Work performed for government agencies, including purchase of imported equipment and services, is often awarded through tenders that are publicly announced or issued to registered suppliers. The government 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 million to $25 million. The sanctity of contracts has also been an issue for some companies dealing with past governments.

The GOP established the Public Procurement Regulatory Authority in May 2002 to introduce and enforce better procurement practices in Pakistan. International tenders are now publicly advertised and the past practice of sole-source contracting by means of company-specific specifications has been eliminated.

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 has withdrawn subsidies on export finance in its most recent trade policy as part of its IMF commitments. 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 fiscal 2002, the Pakistani Government provided export subsidies totaling nearly $9 million.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

The Pakistan government realizes the need to provide better protection for intellectual property rights in order to grow and to protect its nascent information technology industry. Pakistan is a member of the World Trade Organization (WTO) and has 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 WTO 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 Government of Pakistan 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. In CY 2002, Pakistan was, for the first time, the fourth largest source of counterfeit and pirated goods seized by the U.S. Customs Service. The vast majority of these goods were either wearing apparel or media.

Patents

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. 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 $10 million to $15 million per year.

Trademarks

Pakistan enacted a new Trade Marks Ordinance in 2000, 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.

Copyrights

Violations of intellectual property rights in Pakistan are most common in the area of copyrights, where the piracy levels are exceptionally high. Imported computer software is nearly 90 percent pirated (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 disck, 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 have been found for sale in the Middle East and South Asia.

The 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 2000 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. Judges have considerable discretion in awarding a fine or imprisonment or both, with frequently inconsequential fines being imposed. Pakistan could also benefit from more coordinated criminal enforcement and additional support for judicial training, coordinated enforcement, and case management.

Pakistan’s recent amendments to its Copyright Ordinance demonstrate the government’s understanding of the need to modernize its legal system to take into account the latest technological developments. The U.S. government strongly encourages Pakistan as a next step to join the WIPO Copyright Treaty and WIPO Performance and Phonograms Treaty.

SERVICES BARRIERS

In 2000, the Government of Pakistan extended its investment liberalization policy by reducing bureaucratic discretion through new tax codes, and by offering greater tax and other incentives in the infrastructure, services, and agriculture sectors. For example, the modified investment policy places tourism, housing and construction in the category of "priority industries," that pay only a 10 percent custom duty (versus the maximum tariff rate of 25 percent) on imported plant, machinery and equipment, and receive a 50 percent initial depreciation allowance toward the cost of machinery. In addition, there is no minimum equity investment, and foreign investors in these sectors may hold 100 percent equity stakes. 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 FY 2003 budget decreased initial depreciation allowances from 75 percent to 50 percent of machinery costs. The investment liberalization policy 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 an initial depreciation allowance of 50 percent of the cost of machinery. 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 a 100 percent equity stake 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, have been defined as an "industry," which allows foreign investors to hold 100 percent equity stakes, and are neither subject to a minimum investment requirement nor are required to have 40 percent Pakistani equity within five years.

The investment policy in telecommunications 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. Basic telephony remains the monopoly of the majority state-owned Pakistan Telecommunications Corporation until 2003, 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, 2003, and will allow the cross-border provision of packet-switched data and Internet services on competitive networks by 2003. As part of the agreement, Pakistan also adopted certain pro-competitive regulatory principles. The estimated market potential for U.S. Internet service providers and voice-over Internet providers following telephony deregulation in 2003 is $60 million.

Pakistan improved its financial services commitments in the WTO financial services agreement 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 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.

Both domestic and foreign banks are subject to ceilings on lending to state-owned corporations. These are determined by the State Bank of Pakistan, are discretionary in nature and, therefore, 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 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 are, however, 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 government issued a new insurance law in

2000, strengthening the insurance market by raising company capital adequacy standards and offering better protection to policy holders. As a consequence, Pakistan's insurance sector is expected to undergo a large scale restructuring through mergers, acquisitions and closures.

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 (the 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

Foreign investors are allowed to invest in the manufacturing and industrial sector 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 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 on transfer of technology; expropriations only upon adequate compensation; and no changes in benefits and incentives to the disadvantage of investors.

Trade-Related Investment Measures (TRIMS)

The Government of Pakistan appears to have taken the necessary steps to comply with its TRIMS commitments. Their deletion program, targeting the engineering sector, is on track to meet the December 31, 2003, deadline. The most recent Statutory Regulatory Order (SRO) issued on this subject in June, 2002, reduced the number of items receiving concessionary duty protection to 15, sharply down from 262 the previous year. However, the automobile sector will continue to be excluded in the phase down plan, which the Government of Pakistan justifies because other countries also treat this industry as an exception.

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 investigate allegations of corruption under their purview. The government has targeted rooting out corruption as one of its highest priorities, promulgating a strict accountability ordinance facilitating investigations of corrupt acts committed by prior government officials and politicians, tax evaders and fraudulent loan defaulters. There is general consensus that, although corruption has decreased at the highest levels of government, lower level corruption remains endemic.