PN-ABS-487
73848

# U.S. Trade and Investment

Issue: How to use AID resources in ways that are developmentally useful and promote U.S. trade (particularly exports) and investment.

Discussion Points/Hypotheses:

1. Development and rapid sustainable growth usually have positive implications for U.S. exports and U.S. direct foreign investment. Markets expand and opportunities for DFI increase. Stagnation in developing countries (e.g. major debtors) has clearly had negative implications.

2. Many AID project and programs have fairly strong links to exports of U.S. goods and services, e.g. TA, CIPs, capital projects, food aid.

3. It is usually in the developmental interests of recipient countries to have fewer and less stringent restrictions on imports and on direct foreign investment. To the extent that AID pushes in this direction, there is considerable harmony between developmental and commercial goals. The effects on U.S. exports and DFI depend on U.S. competitiveness and entrepreneurship.

4. In some cases where AID has pushed for fewer restrictions, e.g., private sector wheat imports in Philippines and edible oil imports in Pakistan, U.S. exports have been threatened.

5. To the extent that AID efforts focus more directly and specifically on U.S. exports and DFI, conflicts with developmental goals are likely to become more pronounced.

6. Issues of tied aid and mixed credits are longstanding ones (e.g., in the DAC) the U.S. has generally taken an "enlightened" position on these issues, i.e., a position that tries to minimize the use of aid resources by donors to directly promote their own commercial interests.

7. Increasing U.S. exports is usually perceived as unambiguously positive. Increasing U.S. DFI is less clear-cut. The short-term U.S. BOP implications would be negative (capital outflows, perhaps somewhat mitigated by U.S. exports of capital goods) and issues of promoting jobs overseas rather than at home can arise.

Agency and Bureau Strategy and Policy:

The Agency Blueprint is silent on the issue of promoting U.S.

trade and investment, although it obviously emphasizes policy dialogue and reliance on the private sector. The Private Enterprise Development Policy Paper (Revised: March 1985) is quite restrained on promotion of U.S. trade and investment (p.11). It points out that the objective is development of indigenous private sectors; that U.S. private sector activity is a means to this end; but that the test of any activity (for private sector purposes) is whether it improves the LDC private sector or the furtherance of an open, free market economy. The Policy Dialogue paper explicitly does not concern itself with U.S. commercial goals. The Trade Development Policy Paper focuses mainly on achieving more open trade and investment regimes and on promoting LDC exports. There is one page devoted to U.S.-LDC (two-way) Trade Promotion, which mentions interagency cooperation (with ExIm, OPIC, etc.) brokering/consulting firms; joint ventures; and U.S.-LDC Trade associations. The paper also discusses mixed credits as an essentially defensive tool. The Mixed Credits policy determination states that we are opposed in principle to the use of mixed credits for export financing. The Administrator has stated publicly (at the OECD) that introducing commercial objectives into aid tends to weaken and undercut developmental impact.

Both regional strategies treat policy dialogue and the private sector as crosscutting themes, and as means to achieve strategic objectives. Both are silent on promoting U.S. commercial activities. Bureau Programs/Activities:

Consistent with the strategy, most activities to open up trade and investment regimes have been in the broader context of particular projects and programs aimed at strategic goals. Some of our programs, e.g. CIPs (Jordan, Pakistan) and capital/infrastructure projects (Egypt and Pakistan, especially in energy) directly promote U.S. export interests. While use of mixed credits has on the whole been limited, much of the activity that has taken place has been in the ANE region. Several activities aimed at general investment promotion and trade promotion are getting underway.

Opportunities/Next Steps:

The discussion so far points to two distinct though not mutually exclusive approaches. The first is directed towards generally opening up LDCs to trade and investment, by striving to diminish legal and regulatory barriers, improve policies, increase information flows, etc. This fits squarely within existing policy guidance and strategies, and is in general harmony with our developmental concerns. The logical next steps would be to review country programs to see where they can be strengthened in this respect. The problem with this approach is that it is not targeted directly towards U.S.

exports and investment, although the implications are generally but not always positive. It might be usefu to try to measure and document the impacts on U.S. trade and investment of this general approach. The main potential extra-bureau resources would be PRE.

The second approach is directly aimed at U.S. exports and investment. A review of AID and Bureau strategy and policy statements suggests that for the most part this approach has been perceived to conflict with AID's developmental mandate, and would involve a diversion of resources, both human and financial, from other activities. This perception needs to be reexamined with attention to particular elements of this approach. One element would be closer interaction with OPIC, EXIM, TDP, and other agencies concerned with direct promotion of U.S. trade and investment, where resources might be available. A second, related element would be policy and practice with respect to mixed credits and tied aid. A third element would be possibilities for shifting AID Programs in the direction of capital/infrastructure projects; in the direction of CIPs rather than cash transfers; and in other directions known to have an impact on U.S. exports. A fourth element would be programs and activities that are promotional/informational. A fifth element would be to search for development activities such as livestock production where increased output would stimulate demand for imports (feedgrains) where the U.S. may have a comparative advantage.

Work Plan/Decisions:

a. Get AA/ANE reaction to the approaches and opportunities outlined above, including a veto of any obviously unpromising activities, and suggestions of other lines of inquiry.

b. Based on this reaction, create a task force to flesh out existing ideas; inventory existing program contributions to U.S. exports and DFI; develop new options, and define next steps with respect to each possible initiative.

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# TRADE & INVESTMENT

## SUMMARY

This paper provides a discussion of the successes and impediments affecting trade and investment in Pakistan, as well as USAID's approach in supporting US trade and investment concerns. The paper reviews the range of administrative and environmental obstacles confronting US investors as well as USAID's particular experiences in trying to stimulate and support US trade/investment through its commodity import programs. The paper goes on to suggest that USAID's approach should primarily be through greater efforts in areas in which it is already engaged--namely balance of payments support, reforms to improve domestic resources mobilization and activities in the energy and agriculture sectors. Pursuit of trade and investment concerns by USAID may include continued use of policy dialogue and conditionality, broader definition of allowable services under CIPs, continued stress on technology transfer, greater information gathering and dissemination of business opportunities and better targeting of training programs. The linkages with other US Agencies is also discussed. The paper also highlights various policy successes achieved by USAID in supporting trade and investment concerns.

## A. INTRODUCTION

Since achieving independence in 1947 Pakistan has registered an impressive average annual growth rate of 5% per annum. Over the past several years, the growth rate has been further accelerated and has been averaging around 7% per annum. The increase in the growth rate can be directly attributed to a change in the economic management priorities instituted in late 1977. The consequent changes that have been instituted include policies of deregulation, liberalization, restriction and eventual contraction of the public sector, and an enhanced role for the private sector in the country's economic development. Though these policy changes were welcome news, progress on some of these matters has lagged behind official pronouncements. In addition, structural problems continue to plague the economy. Of late, these include a widening budget deficit and a weak balance of payments situation coupled with low rates of domestic savings and investments. These challenges will continue to hound the economic managers of Pakistan for the foreseeable future.

Trade relations between the U.S. and Pakistan are generally satisfactory with no country-specific barriers being applied to U.S. exports to Pakistan. However, there is some resentment in Pakistani business quarters over the quota restrictions levied by the U.S. against Pakistani cotton and textile exports.

The U.S. continues to be Pakistan's largest trading partner (including military sales) Excluding U.S. military sales to Pakistan, the quantum value of trade between the two countries has been as follows:

| | PFY'85 | PFY'86 | PFY'87 |
|---|---|---|---|
| | | ($ millions) | |
| U.S. Exports to Pakistan | 737 | 672 | 593 |
| Pak. Exports to U.S. | 257 | 318 | 373 |
| Deficit | 480 | 354 | 220 |

The declining trend in U.S. exports to Pakistan can be attributed to: (i) exchange rate fluctuations (the rupee has depreciated by 44 percent against the U.S. dollar since 1981); (ii) aggressive marketing of complementary products by U.S. competitors like Japan, South Korea, Taiwan. However, the U.S. still enjoys a competitive edge in the export of high tech products such as turbines for electric power and computer hardware and software. It is in these areas that the U.S. needs to focus more in its export mix for Pakistan.

For the past six years, U.S. private investment in Pakistan has been averaging a little over $6 million per annum. Also during the last six years, imports from the U.S. represented on average an 11% share of total Pakistani imports. Under the PL-480 Title I program, USAID has importing edible oil worth $50 million per annum from the U.S. for the past several years. Under the agricultural and energy Commodity Import Programs the mission has facilitated on average the import of $______ million per annum over the past few years.

## PAKISTAN'S TRADE - 1985/86
(% Share)

| Country | PAKISTAN'S Exports To | PAKISTAN'S Imports From |
|---|---|---|
| U.S.A. | 10.4 | 11.9 |
| JAPAN | 9.6 | 14.9 |
| SAUDI ARABIA | 7.0 | 7.9 |
| WEST GERMANY | 6.0 | 8.6 |
| U.K. | 5.5 | 6.6 |

## FOREIGN PRIVATE DIRECT INVESTMENT
(PER ANNUM AVERAGE: 1981-86)
(Millions of Dollars)

| | |
|---|---|
| U.K. | 9.1 |
| U.S.A. | 7.1 |
| SAUDI ARABIA | 5.0 |
| WEST GERMANY | 0.7 |
| JAPAN | 0.1 |

## B. OBSTACLES CONFRONTING TRADE AND INVESTMENT PROSPECTS IN PAKISTAN

Since 1977, the GOP has taken steps to revive the private sector and attract private foreign capital. Its stated objective is to focus industrialization efforts on export-oriented, capital intensive and high technology industries. When Prime Minister Junejo visited the U.S. in the summer of 1986, he made a special effort to assure the U.S. that foreign investment was encouraged at the highest level. Both he and President Zia have since reiterated that policy on many occasions. They and other policy makers have also been increasingly willing to assist foreign investors in resolving bureaucratic problems. Currently a plethora of regulations and a maze of regulatory institutions inadvertantly tend to scare away much needed foreign investment. The following are, to varying degrees, impediments that tend to inhibit direct foreign investment in Pakistan:

Political Risk: The continued Soviet occupation of next-door Afghanistan, and Soviet sponsored terrorism within Pakistan contribute towards a less than sanguine perception of Pakistan in the eyes of foreign investors. The country has had extended periods of martial law, survived three major conflicts with India, and had to face the consequences of nationalization policies during the tenure of the former political government. Frequent ethnic disturbances in Karachi, Pakistan's largest city, which is also the country's center of commerce and finance, contribute towards a less than positive image of the country.

It must be noted that in spite of the nationalizations carried out in the 1970s, no joint venture or foreign investment has ever been expropriated by any government in Pakistan.

__Domestic Resource Mobilization__: Pakistan's formal economy is characterized by low rates of savings and investments. This means that the country is continually dependent on foreign assistance for the achievement of its development objectives. Low levels of direct taxation and large expenditures on defense and debt servicing have resulted in an inadequate physical infrastructure. In order to provide adequate funding for the 7th Five-Year Plan, the Government is currently contemplating such measures as raising taxes and user charges along with moving selected parastatals off budget.

The domestic resource mobilization problem is further exacerabated by the presence of a large "black economy" whose magnitude is about 40-50% of the recogonized economy. Lack of well functioning secondary capital markets contributes towards a bias of debt as opposed to equity financing.

__Financial sector__: The financial sector in Pakistan is characterized by: (a) prominent presence of public sector institutions; (b) little diversity in the variety of financial institutions; (c) heavy dependence on development finance institutions for development activity; (d) lack of a vibrant capital market. Currently there are only 30 odd stocks actively being traded on the Karachi Stock Exchange.

The banking system in Pakistan is comprised of the State Bank of Pakistan (the central bank), five nationalized commercial banks, 16 foreign banks, specialized banks and financial institutions and cooperative banks. Of the 16 foreign banks, U.S. banks are represented by Bank of America, Chase Manhattan, Citibank, and American Express International Banking Corporation. The nationalized commercial banks, as the largest deposit institutions, are the main source of short and medium term credit for domestic investment. The latter banks include Allied Bank of Pakistan Ltd., Habib Bank Ltd., Muslim Commercial Bank Ltd., National Bank of Pakistan, and United Bank Ltd. In addition, there are five major development financial institutions (DFIs) which currently cater to the needs of the public as well as private sector.

Trade Regime: The current trade regime and tariff structure tends to restrict imports and encourage inefficient domestic production in many industries. Most of Pakistan's large scale manufacturing sector has grown behind the protection of high tariff rates, and hence is unable to withstand the rigors and discipline of international competition. Ironically, the private sector is one of the strongest advocates of maintaining high protection rates so it can continue to produce, albeit inefficiently, for the lucarative domestic market.

Structure of Protection: Pakistan's import regime reached its most restrictive stage in recent decades during the October, 1979 - December, 1980 period. Almost 43 percent of domestic industry (in value added terms) was protected by import prohibitions, and another 22 percent by various forms of import restrictions. While non-tariff barriers served as a major instrument of protection with a high incidence on consumer goods, importable items that escaped ban faced extremely high custom duties. According to the World Bank the unweighed economy-wide average tariff rate was about 77% in the early 1980s, but the variation in tariff rates was very large. Specifically, consumer goods carried much higher tariff rates than other major categories followed by capital goods and then intermediate goods. In addition, the sales tax, which was levied at higher rates on imports of certain goods than their domestically produced substitutes, further reinforced the effects of customs duties on the landed cost of imports.

Since 1980 Pakistan has embarked on a process of gradual liberalization of its foreign trade sector. The trade policy changes introduced in the 1980s include: (i) removal of license value ceilings (i.e. explicit import quotas) on most non-capital goods imports; (ii) liberalization of some banned and restricted items; (iii) replacement of the positive import list system with a negative list system; (iv) adoption of flexible exchange rate system; and (v) removal of compensatory rebates. At the same time a 5% across-the-board surcharge on the C.I.F. value of imports and a subsequent second 5% surcharge were also introduced. By virtue of these changes, the percentage of industrial value added hitherto protected by bans was reduced from 43% to about 27% and that protected by other import restrictions from 22% to about 0.2% by the end of 1983. In proportionate terms the largest decline was in capital goods for which the average tariff decline was from 67% to 54%. Within this category, tariffs for some machinery were either halved or reduced to zero from their previous 20-40 percent range. Intermediate goods tariff cuts were the smallest, reducing the average from 60% to 56%; and tariffs on intermediate goods remain relatively high by international standards.

Export Regime and Exchange Rate Policy: Since the delinking of the rupee from the US dollar and the adoption of a managed exchange rate system in January 1982, the general direction of change in Pakistan's export regime has involved an increased reliance on the effective use of exchange rate policy, reduced reliance on direct export incentives (e.g. compensatory rebates) and more attention to the costs of imported inputs. By calculating the ratio of "Effective Exchange Rates" (EER) for imports and exports, it is possible to determine whether a trade regime is neutral, import substitution biased, or export promotion biased. Neutrality is implied if the ratio is 1; a ratio greater than 1 implies bias towards import substitution and lower than 1 towards export promotion. Taking the U.S. dollar as the reference currency, the World Bank calculated EERs for Pakistan for FY81, FY85 and September 1986. These calculations show an import substitution bias that if anything has become more pronounced over time; the reduction in bias stemming from tariff cuts has been more than offset by the imposition of import surcharges and the elimination of compensatory rebates on selective products in July 1986. These figures show that, in addition to an active exchange rate policy, there is a need to remove any direct disincentives to exports stemming from high cost imported input, and to reduce and eliminate the current developmental incentive in favor of production for the domestic market.

Investment Sanctioning Process: In spite of the rhetoric from top political authorities the investment sanctioning process is cumbersome, slow, fraught with corruption, and the behavior of officials arbitrary and sometimes harassing. The process is viewed as overly selective in sanctioning new and expansion of existing projects. The sanctioning process is never the same for any two investors; in fact there are wide differences in the number of GOP agencies involved, the order, the progression, and the response time and pattern. A prospective investor currently has to deal with three or four different agencies before sanctioning is even approved in principle. It is not uncommon for those who persist to have to wait as long as three to four years to obtain final approval. Market conditions and opportunities quite often change in the meantime, and hence only those with a long term perspective tend to consider investing in Pakistan.

Foreign investors have remained cautious about capital investments in Pakistan, however. Foremost among the reasons for this hesitancy is the perceived level of government control, cumbersome investment sanctioning procedures, high effective corporate tax rates, unrealistic indigenization and location policies, and infrastructure shortages. There has been a perception of political risk associated with investment in Pakistan, given the political uncertainties of the war in neighboring Afghanistan and the periodic tensions along the Indo-Pakistan border. The continuing civil disturbances in the Sind and their effect on business activities also reinforce this impression. Businessmen in Karachi have reported, however, that the disturbances in Karachi have not had a serious impact on their profitability.

Foreign private investment is governed by the Foreign Private Investment (Promotion and Protection) Act of 1976 administered by the Ministry of Industries. This act provides security against expropriation and adequate compensation for acquisitions. It also guarantees to foreign investors the right to repatriate funds up to the amount of the original investment, profits, and any additional amount resulting from re-invested profits or appreciation of the capital investment. Foreign nationals employed in industrial undertakings having foreign private investment may make remittances of their monthly salaries or (at the end of their tenure) of their accrued savings. National treatment with respect to laws, rules, and regulations relating to import and export of goods is provided. In addition, the U.S.-Pakistan Treaty of Friendship and Commerce provides for national treatment of U.S. business people in other areas. There is also a bilateral treaty providing for the avoidance of double taxation.

Pricing Policy: While the GOP retains considerable powers to impose price controls on the economy, it has been moving away from this practice. These controls remain on drugs and pharmaceuticals, however, and represent a major on-going problem for foreign drug companies. The controls are administered by the Ministry of Health, which suspects the foreign drug companies of transfer pricing.

Taxes, Investment Incentives and Performance Requirements: The GOP Ministry of Industries published policy statement on investment incentives states that "basically all the incentives, concessions and facilities provided for industrial investment to the local investors are equally available to foreign investors without any discrimination." The same statement also says that "in order to accelerate industrial development in the country, a number of tax concessions have been provided, such as exemption from customs duty, deferment of duty, sales tax concession, income tax relief, super tax rebate, tax exemption on investment, tax credit, liberal depreciation allowance, repatriation facilities and protection of deserving industries." It goes on to state, however, that "these concessions are provided only to such plant and machinery as are specified in various notifications issued by the Government and subject to such conditions as are prescribed in these notifications." In addition, a 5 percent import surcharge and a 5 percent Iqra surcharge is levied on all imports.

The bottom line is that there are a number of incentives available to foreign investors, but the rules governing them are complex and administered by a bureaucracy given to micromanagement. In the final analysis, the concessions available to a given company will depend upon what it is able to negotiate in the sanctioning process.

**Labor Force:** Unskilled labor is abundant and cheap in Pakistan. Unemployment and underemployment are fairly high, though official estimates are unreliable. Skilled labor in many fields, however, is in short supply. Among the factors responsible for this is the extremely high illiteracy rate (probably well over the official estimate of 75%). Other contributing factors include a deficient education system, and until recently, the attraction of many skilled workers to more lucrative employment outside Pakistan (notably in the Gulf). This trend has reversed somewhat in recent years, and especially in the petroleum industry, U.S. companies have reported the availability of high quality employees. Government leaders are addressing the question of appropriate education for the labor force. Individual companies have reported good results from training programs initiated for their own workers.

Pakistani employers are now frequently resorting to contract labor as a means of escaping responsibility for many of the fringe benefits paid to regular employees, as well as to avoid the restrictions on laying off workers. Legal provisions for worker protection and benefits are widely violated and weakly enforced. Foreign employers, however, are more likely to be held accountable.

Labor-Management Relations: Relations between labor and management in Pakistan are generally peaceful, but not always cordial. U.S. companies with more modern approaches to labor-management issues have generally enjoyed good relations.

Organized unions exist in abundance but are generally small, fractious and organized within a single plant. Unions are barred from large sectors of employment (though not generally from industry) and legal limitations on strikes are so strict as to make them rare. The general poverty of the unions, and lack of financial reserves by most workers are also deterrents to strikes. Lesser forms of labor agitation do occur, however.

Infrastructure: Prospective investors are particularly concerned about the lack of power, roads and communication facilities. With respect to communications, companies have a problem in running their existing operations, and for some companies the lack of a communications network hampers their expansion plans. Companies particularly mention the lack of power and roads in the "tax-free" zones. It is debatable whether the tax incentives are sufficient to offset the lack of infrastructure in these zones. Some prospective investors state that it is not only lack of essential services but also the delays in receiving them that are equally troublesome. Other problem areas which are frequently sighted include: royalty and technical fee limitations; limited access to government clients; and weak enforcement of copyright and patent laws.

## C. MISSION EXPERIENCE WITH PRIVATE SECTOR COMMODITY IMPORT PROGRAMS

In its efforts to assist the Pakistani private sector and indirectly provide U.S. firms with opportunities to establish a presence in the local market through exports, the Mission established two private sector windows in its agricultural and energy commodity import programs. The success of these two programs to date has been quite disappointing. With virtually no activity for the first two years, the Mission commissioned a study in order to identify the factors responsible for the dismal performance of the private sector windows. According to the findings of the study, 75% of the Pakistani importers surveyed cited higher cost of imports from the U.S as the main barrier. The attitude of U.S. exporters and quality of U.S. products were among the six main barriers cited by the local importers. More specifically, it was argued that:

(A) Prices of U.S. goods are 10% higher than those from Europe;

(B) Prices of U.S. goods are 10-15% higher than those from Japan; and

(C) Prices of U.S. goods are 25-33% higher than those from such East Asian countries as S. Korea, Taiwan, and Malaysia.

Based on responses of importers with prior experience of importing from U.S., the study indicated that fully 30 percent of wholesalers and 33 percent of end users were dissatisfied with their U.S. purchases. Other factors such as: lack of U.S. staying power in the market place, lack of after sale service, and a lack of local agents/distributors also tends to hamper U.S. exports to Pakistan. On the other hand the U.S. still dominates the market in high tech equipment such as computers and combustion turbines like the ones USAID installed at the Guddu Power Plant. The Mission experience suggests that those U.S. firms which are determined to be present in the local market ultimately are quite successful. Certainly, the presence of four big name U.S. commercial banks would testify to this fact, as would the recent approval gained by Cargill--which after persisting for three years--finally got the approval to establish an export oriented fruit juice plant.

Another Mission sponsored study (regarding PSCIPs conducted by Coopers & Lybrand further substantiates our earlier expressed reservations. For instance, the Coopers & Lybrand study) notes:

> "**Business Ties:** It is evident from our review that Pakistan more closely associates with Western Europe and Japan in terms of traditional business relationships. U.S. companies are not well represented, especially with regard to intermediate and capital goods. However, it was observed that the U.S. still dominates in certain sophisticated and high technology products such as drilling and irrigation equipment.
>
> **Freight Costs:** Because of U.S. source restrictions, local importers would incur higher transport costs than if goods were imported directly from either Europe or Japan.
>
> **Interest of U.S. Manufacturers:** There is well supported evidence to conclude that U.S. manufacturers are not very enthusiastic about doing business in Pakistan. Indeed, in many instances, U.S.

companies have not responded to advertisements for tenders. It was also mentioned repeatedly that U.S. manufacturers, unlike competitors from Europe and Japan, do not aggressively market their products in Pakistan. It was suggested that because of the relatively small size of the market and of each order, U.S. companies do not yet view the Pakistani market as warranting aggressive sales campaigns.

Specifications of U.S. Products: On a number of occasions it was mentioned that U.S. products, especially those relating to the agricultural sector, are not suited to conditions in Pakistan. For example, harvesters and combines available from the U.S. have more capacity than what is typically needed in Pakistan. We also found instances where more suitable U.S. equipment and machinery could be found, but through European subsidiaries."

In addition to the above, we also have various restraining factors on the PSCIP from the U.S. and the GOP side. Some of these are the 50/50 shipping requirement; the restriction of the program to a geographic code 000 only; the cost of U.S. products; and GOP restrictions on the importation of certain commodities which are eligible under A.I.D. financing but can only be imported by public sector entities into Pakistan.

## D. USAID TRADE AND INVESTMENT OBJECTIVES AND APPROACHES

### Mission Strategy

Any broad based initiative in trade and investment must be country specific. The US-Pakistan relationship has been characterized by relative uneveness with a few periods of grave stress. Hence when U.S. economic assistance was restored in 1981, the package was designed quickly with major importance being attached to a fast disbursing mode: first to provide much needed balance of payments support, and secondly to "buy-time" for the government of Pakistan to undertake much needed domestic economic reforms. Though progress on the latter has been steady but slow in coming, USAID has played a seminal role in moving the Pakistan economy away from its focus on nationalization characteristic of the economy in the 1970s. Nevertheless, the legacy of those years still haunts the domestic policy environment to a considerable degree.

The Mission intends to continue its efforts for facilitating greater trade and investment between the U.S. and Pakistan by its continued presence in Agriculture and Energy, the two dominant sectors of the Pakistani economy. In addition, Mission efforts will also focus on efforts to improve Pakistan's domestic resource mobilization efforts and the balance of payments situation, as a facilitating mechanism for enhanced trade and investment activity.

For the 1988-93 period, USAID's strategy is to bolster political stability and national integration through programs of economic and social development. The strategy concentrates on generic challenges extending across a number of sectors: reform of the policy, institutional and managerial environment, development of human resources and sustainable improvement of physical infrastructure. The four major areas where USAID's strategic objectives and resources converge with trade and investment concerns are: balance of payments, domestic resource mobilization, increasing agricultural productivity, and increasing energy availability.

The above four areas: Agriculture, Energy, DRM, BOP were also outlined in the Mission's Country Development Strategy Statement (CDSS) as problem areas requiring continued involvement of USAID. It is in these areas that the Mission has the requisite expertise to facilitate advancing Trade and Investment concerns. Furthermore, the Mission will continue to use the policy dialogue vehicle to press upon the Government of Pakistan to pursue a more outward- oriented growth strategy, reduce, and subsequently eliminate, barriers that tend to obstruct the cause of trade and investment. In this connection, it should, however, be noted that U.S. sponsored trade barriers such as the quota restrictions on imports of Pakistani textiles run counter to the aim of enhancing greater trade and investment activity between the two countries. The Mission strongly believes that T&I is a two way street and for the trade and investment initiative to succeed, trade barriers on both the U.S. and the Pakistan side may need to be reviewed.

The Mission also intends to continue to use the PSCIP window as a vehicle of promoting further U.S. trade to Pakistan.

Besides the four problem areas (outlined above), the Mission would also respond to windows of opportunity as they evolve. The Mission believes that its overall approach towards the trade and investment initiative should be one of complementarity to our existing portfolio and strategy as outlined in the Mission CDSS.

Mission Response to-date: The Mission recognizes that rapid growth in trade and investment has been associated with broadly-based sustainable growth in Asia. The records of such countries as South Korea and Taiwan support this generalization, and indicate the benefits of an outward-looking strategy. As such, successful efforts by USAID to foster broadly-based sustainable growth will yield dividends in terms of substantial increases in trade and investment. Likewise, trade and investment can both cause and reinforce such growth. USAID is actively involved in nurturing Pakistan's long-term sustained economic growth with its attendant trade and investment dimensions by utilizing various approaches, some of which are outlined below, to address overarching energy, agriculture and macroeconomic concerns.

**Policy Dialogue:** Besides on-going reviews, the Mission has held semi-annual ministerial-level policy dialogues with the top economic managers of Pakistan in an effort to discuss means of liberalizing the country's rigid economic management, ensure a greater role for the private sector, reform the trade and tariff structures, and promote deregulation/divestiture, reform of the financial system, streamlining the investment sanctioning process, and rationalizing the pricing structure. Our efforts are designed to ensure that market mechanisms are employed across an array of economic variables. The presence of market-place mechanisms is a necessary pre-condition for attracting foreign investment from abroad including, of course, the United States. The Mission also has been attempting to persuade the GOP to adopt export-led growth policies and minimize import substitution policies that encourage inefficient industrial production. USAID's Economic Policy Dialogue is closely linked to and reinforces the annual U.S.-Pakistan bilateral Economic Subcommission meetings which also address bilateral trade and investment issues.

**Infrastructure:** The Mission considers the presence of vital infrastructure to be an important pre-condition for the expansion of trade and investment policies. As such, the Mission is actively involved in providing assistance to the GOP for infrastructure activities such as power, roads, social infrastructure, etc. to support the acceleration of industrial expansion. Pakistan's energy deficiencies are often cited as the single most important obstacle to industrial expansion.

**Balance of Payments:** Through various projects, PL-480, and CIPs, the Mission provides highly valued support to Pakistan's balance of payments position, which permits large imports of raw materials, intermediate goods, and capital equipment necessary for economic growth. Concomittantly, the Mission has regularly identified the various action measures which the GOP must adopt to overcome the structural weaknesses inherent in its balance of payments structure.

**Financial Sector:** The Mission views the presence of a vibrant financial sector as a necessary element for enhancing trade and attracting foreign private investment. Greater liberalization of the financial system would serve as a catalyst in attracting multinational investments from the U.S. In response to the strenuous efforts of the Mission, the GOP recently announced the general rules for the establishment of private sector investment finance companies which may, in effect, be a precurser to the reintroduction of private banking into Pakistan. The Mission will continue its initiative of further liberalizing the financial sector by pursuing the establishment of private housing finance insitutions, as well as credit allocation based on market mechanisms. In this area, Mission efforts are closely linked to World Bank structural reforms targeted for the financial sector.

**Private Sector:** The Mission recognizes that trade and investment are inherently market activities that most efficiently involve production and exchange of private goods and services, not public goods. The Mission continues to believe as a cardinal principle that trade and direct foreign investment can be most efficiently carried out by the private sector if a satisfactory market environment prevails. Thus, the Mission has been very active in attempting to persuade the GOP to create a 'level playing field' for the private sector. Our involvement in advancing private sector initiatives is driven by argiments of economic efficiency and domestic resource mobilization. Experience from other developing countries and the less than sanguine consequences of nationalizations in Pakistan during the 1970's suggests that the GOP should not continue to be involved in the whole array of economic activity ranging from production to regulation. Budgetary pressures along with changes in economic thinking are causing the GOP to increasingly pursue reform measures along those lines.

The Mission has actively supported the GOP's position that the private sector should be the economic mainstay and development engine of Pakistan. As a result of our efforts supporting economic liberalization, the private sector has been allowed to import edible oils, set up cement plants, and invest in electric power generation. The Mission believes that greater private sector involvement in economic activity is not only warranted by the arguments of economic efficiency and domestic resource mobilization, but that it also creates greater opportunities for expanded U.S. trade and investment.

As noted before, the Mission currently uses such instruments as policy dialogue, PL-480, balance of payments oriented sector support projects, project conditionality, and donor coordination to create a "level playing field" for the private sector--both of domestic and foreign origin. Currently the Mission has a number of initiatives which would have a salutory effect for U.S. business interests in Pakistan, and of attracting direct foreign investment from abroad including of course that from the United States. These activities include Mission involvement with efforts supporting agribusiness, private sector power generation, private energy resource development, private oil and gas joint ventures with the public sector, private sector assumption of traditional public sector roles in infrastructure and the social sectors, establishment of private investment companies (through our earlier lobbying efforts with the GOP), and a possible project to mobilize private capital for housing needs.

The Mission continues to believe that in addition to pursuing the above initiatives, the cause of enhancing U.S. trade and investment can best be accomplished by USAID/Pakistan pursuing policies and strategies that:

Ensure medium/long-term sustainable growth. In the long run this is the only sure bet. As the Pakistan economy continues to grow, and as per capita incomes continue to rise, substantial opportunities will themselves be created for a bigger and expanded market for US goods. More Direct Foreign Investment (DFI) in Pakistan now can contribute to sustained economic growth.

In other words, ensuring Pakistan's continued economic growth would also ensure a bigger and more sophisticated market for other exporting countries including the U.S. Therefore, identification and eventual removal of constraints to the growth process would, as a by-product, also help to invigorate U.S. trade and investment in Pakistan.

## USAID'S TRADE AND INVESTMENT OBJECTIVES AND ACHIEVEMENTS IN ACTIVE SECTORS

Principally through the instruments of policy dialogue, project conditionality, training, sector support projects and PL 480 self-help measures, the Mission has been able to build up a track record of policy reform which has had a salutory effect in creating a more open economy. The following identifies trade and investment related policy changes undertaken by the GOP, in various sectors, based upon interaction with USAID:

### AGRICULTURE:

The Mission has an ongoing agribusiness effort which aims to facilitate trade and investment opportunities with the agriculture sector. This program sponsors seminars and workshops (horticulture, seed), sends participants to short-term and long-term training, assists U.S. businesses to establish contact and break through local red tape, and pursues continuous dialogue with the GOP on matters of tariff reform, price policy, sanctioning requirements and credit policy. A grain storage seminar and a fruit and vegetable investment forum are planned for FY 1988 as is a much expanded private sector training effort. A major new USAID activity, the Agriculture Sector Support Program (ASSP) will promote agribusiness. USAID has seen positive movement on some tariffs; two U.S. seed companies are negotiating joint ventures, Cargill has had a frozen juice concentrate plant sanctioned, active consideration being given to amending the Seed Act of 1976, a process to get the private sector involved in grain storage is ongoing, and the private sector is now permitted to export cotton and rice in competition with parastatals.

The mission's policy and technical assistance for horticulture and seed activities is provided by the Industry Council for Development and its multinational and Pakistani corporate members. It is expected that within the next several years a major shift to hybrid seed will take place with substantial opportunities for U.S. private sector participation. The mission anticipates sponsoring an activity with the International Executive Service Corps (IESC) so that its assistance to entrepreneurs and corporations can be expanded and hence Pakistan's private sector can tap the IESC Trade and Investment Service. Privatization issues in fertilizer are primarily pursued under the Agricultural Commodities and Equipment (ACE) import program, which incorporates policy benchmarks based on the findings of a detailed study of the fertilizer subsector funded by USAID.

The mission has achieved significant deregulation of the edible oils industry Pakistan's largest import after petroleum. Major changes include the removal of price controls on vegetable ghee and edible oil, elimination of restrictions on imports of both palm oil and soybeam oil by private sector manufacturers of vegetable ghee, substitution of a Rs.3,000 per ton regulatory import duty for the excise tax and import surcharge currently levied on vegetable oil imports. Support prices for oilseeds will continue, as well as the sanctioning requirement for new investment. These changes are a substantial liberalization of the economy and, we believe, the partial result of three years of policy dialogue in the PL 480 Program.

USAID is examining placing additional emphasis on private sector agricultural activities that directly improve on-farm and off-farm income and employment; activities which address the goals of the National Agricultural Commission report and the Seventh Five-Year Plan targets. This concept will provide support to the farming marketing and processing community and develop increased technology transfer and servicing by the private sector in competition with, and as an alternative to, traditional public sector "vendors" of extension, seed, markets and services. Initial investigations reveal potential in dairy, feed grain, animal husbandry and horticulture.

As a result of the AID financed Seed Industry Seminar (inaugurated by the President of Pakistan) major reforms are taking place within the seed industry. Administrative rules and regulations which heretofore retarded change and, in essence, precluded private sector participation are being changed. Cargill is established, and Pioneer's Board of Directors has voted to make a multi-million dollar investment in Pakistan. Lever brothers (Interstate Seed U.S.) is planning to set up shop and others have expressed serious interest. The Turkish and Thailand models and result in the seed industry are being watched and emulated by the Pakistanis.

Promotional activities and research between the Pakistan Agricultural Research Council, the Poultry Industry and Millers, and the American soybean Association is beginning.

Domestic restrictions on marketing rice and cotton have been removed and the private sector is beginning to compete with parastatal export houses. The wheat ration system has been dismantled and the way opened for greater private sector storage in wheat marketing. In summary, substantial progress is being made by the Pakistanis in the realm of deregulation and greater private sector participation in the economy. While much remains to be done, recognition of the role of market signals is evident and more progress in the future can be envisioned including a more conducive environment for expanding trade and investment.

The establishment of a substantial private sector training program revesed decades of precedent where only public sector employees had access to AID grant funds. The program has been funded for the next six years.

**ENERGY:**

**Private Sector Power:** The Mission has been working with the GOP in several areas to stimulate the growth and development of the private sector in energy (which until recently was reserved almost exclusively for state controlled enterprises). This activity began primarily as a dialogue under the Energy Planning and Development Project. The purpose of the dialogue was to involve private sector firms, both foreign and domestic, in the generation of electricity. The deficit of generating capacity was so large that the public sector agencies did not have sufficient administrative capability and financial resources to reduce the power supply deficit in an acceptable period of time thereby leading to massive load shedding with a constraining effect on private sector industrial growth. The Mission sponsored studies to identify various administrative barriers to private sector activities in this field. These studies estimated the payment for electricity that private sector firms would have to receive in order to make the necessary investments. As a result of the studies and various discussions, the Ministry of Water and Power issued regulations allowing private sector power generation and carried out its own studies to determine the price it would be willing to pay for power. This price was based on the cost of new thermal generating capacity in the public sector rather than the average cost of power in the entire system.

As a result of this dialogue, the GOP has gone ahead with a letter of intent to purchase the output of 130 MW of coal fired power generation capacity from a local-foreign joint venture and has both requested and received numerous proposals for private sector power projects using Pakistan's coal and gas resources and imported oil. The World Bank is also actively involved with private sector power generation and is designing a multi-donor project in which it would provide substantial amounts of money as loans to private firms for the development of such projects. USAID is designing a parallel private sector power project, which may involve cofinancing with the World Bank project.

The purpose of the new USAID/World Bank projects would be to add to generating capacity more rapidly and more efficiently than the public sector can achieve. It will be designed to apply private sector managerial, technical, and financial resources to the problem and mobilize financial and skilled personnel resources both domestically and from abroad that are not readily available to the public sector.

Policy dialogue on private sector power has been successful because of the obvious benefits to the economy and to the Government of Pakistan. Elimination of loadshedding and electrification of 90% of Pakistan's villages by 1990 are two major objectives of the Prime Minister; USAID financed studies made it clear that the public sector could not achieve these goals even by a later date unless very large electricity rate increases and private sector power would be provided to supply financial and infrastructure resources. The coincidence of economic benefits with an important political objective probably accounts for the high degree of success so far. Private sector power activities which may be financed by this new project would expand investment in the power sector as well as in supportive energy fuel resource exploration and development. At least half of the investment will involve imports of machinery and project management and specially skilled manpower. U.S firms and U.S. equipment are extremely likely to be involved in some of these projects. It is likely that the pattern of development will be beneficial for the country in terms of relieving the electricity deficit in a timely and cost effective manner. The projects that use indigenous fuel will be especially valuable by reducing pressure on the balance of payments.

__Oil & Gas__: The oil and gas sub sector is a prominent and highly dynamic area in Pakistan's economy as well as a prime target for further U.S. trade and investment opportunities. Recently USAID sponsored a national oil and gas symposium in support of the Ministry of Petroleum's effort to formulate a new national oil and gas policy which would: (a) attract more private sector exploration through development companies and investors as well as (b) better define and channel the role of GOP's public oil and gas agencies. The mission believes the symposium served as an outstanding example of how AID can support a host government which is seeking to attract more foreign trade and investment opportunities.

Over the past decade, Pakistan has attracted up to $1.5 billion in foreign investment, evenly dividied between private corporations on the one hand and multilateral and bilateral donors on the other. To achieve its ambitious oil and gas exploration, production, refining and product distribution plans for the next five years, Pakistan must attract investments of over another $1 billion from the private sector alone, as well as $1.5 billion from its Annual Development Plan. These levels represent significant opportunities for U.S. Trade and Investment in Pakistan, given the lead role of U.S. companies and U.S. technology in the oil and gas sub sector as well as America's prominent presence here already in petroleum exploration and production (Occidental and Union Texas account for up to 80% of domestic oil production). This should be of tremendous benefit to Pakistan: Over two-thirds of Pakistan's increases in oil production over the past five years are the direct result of discoveries and development by the two private U.S. firms noted above.

The symposium was helpful in raising national public awareness and senior GOP official's consciousness about the important benefit brought to the petroleum sector by private investment and to the room for improvement in Pakistan's policies to attract even more private investment. The symposium helped demonstrate a convergence of views on important issues, and provided a forum for private sector view points. It also gave the GOP a chance to publicly show new potential investors that it has had an open door policy, for which foreign firms already involved here publicly commended the GOP during the symposium. It provided an opportunity for potential new investors to compare notes with firms already in-country for establishing possible future cooperative arrangements, and to weigh the risks with the benefits of investment in Pakistan.

In order to pursue with the GOP some of the reform measures raised in the symposium, the mission has taken the lead to informally coordinate oil and gas donor efforts at the technical staff level among USAID, CIDA, World Bank and Asian Development Bank. Future USAID discussions with the GOP planned for 1988 will focus on reforms of: gas pricing, GOP oil and gas institutions, fiscal incentives for producers, and concession agreement procedures. Finally, as an outcome of this symposium's call for more public awareness of energy conservation, the mission has reached agreement with Ministry of Planning and Ministry of Production to support another major 3-day symposium in early August 1988. It is expected that there will be international participation featuring American firms specializing in energy conservation equipment and services during this symposium.

The Mission has been active in promoting the development of Pakistan's coal resources by the private sector through an extensive Coal Resource Assessment Program (COAL REAP). The mission has also assessed the coal briquette market and the types which should be produced by private sector as a substitute for wood fuels and kerosene. The Mission organized and sponsored the "First Pakistan National Coal Conference" in 1986 which provided information to 400 private sector delegates (including 50 American businessmen) on the potential for development of coal resources in Pakistan by the private sector.

Other energy sector specific experience with the private sector includes: the promotion of risk-shared development of the Dhodak Condensate Gas Field by the private sector; industrial energy conservation assistance to over major 100 industrialists in the private sector; Private Sector Commodity Import Program which provides credit for the import of U.S. energy related machinery, equipment and materials needed by the private sector; the promotion of and support with commodities of joint ventures between private oil and gas development firms and the Oil and Gas Development Corporation for appraisal and development of oil and gas fields; using commodities to leverage gaining the GOP policy decision made recently to allow natural gas to be used as fueld for electric power plants by the private sector.

## FINANCIAL SECTOR:

For a number of years, USAID has been interested in stimulating liberalization measures in the finance sector. Since the 1970s all domestic banks are government owned and credit is closely managed by the central bank (State Bank of Pakistan). AID initially proposed to partially capitalize a privately owned investment company which would serve as a model for introducing more modern investment techniques and also stimulate the capital market in Pakistan. In our continuing dialogue with the Government, we helped advise them on developing a set of rules which would allow establishment of these investment companies. These regulations are about to become effective and legal investment companies will soon start operation. The mission is confident that visible proof of the utility in letting a market mechanism allocate credit will soon be evident through these companies.

The Mission is currently exploring the feasibility of developing a Housing Guaranty Program (HG) to tackle self-sustaining finance questions which could open up a private sector role in an area now totally dominated by the public sector. The HG would also serve as a vehicle to address broader issues of credit allocation, regulation and capital markets. The approach could include privatization of the Government housing parastatal, support for new private sector savings and loan institutions, as well as provide added momentum to private investment companies and other private credit institutions, and advance the role of local level autonomous organizations.

The Mission is also exploring ways in which private sector investment can be used to build public infrastructure on a risk capital basis. As a pathbreaking activity, the Mission is supporting the financial packaging of the private sector construction and ownership of the proposed Lahore-Faisalabad toll road. If successful, this would demonstrate to the GOP that government infrastructure operations could be moved into the private sector. Perhaps of even more significance, this activity would expand awareness that private business can perform other governmental functions at a considerable cost savings to the economy.

## POPULATION:

The Mission, working with the GOP, agreed to a social marketing project that builds on private sector marketing strengths to increase the demand for and distribution of contraceptives. Under this project, private Pakistani firms are being used to promote the sale of contraceptives through private sector distribution channels. During the brief period of actual project implementation, over 40,000 retail outlets have been established throughout the country. The Mission has recently gained the GOP approval to expand this approach to address the health sector more generally.

## TRAINING:

The GOP/USAID Private Sector Scholarship program, an increasingly important development training activity, has generated several thousand applications from Pakistan each year. Under this program, officials have identified and selected on a merit basis 300 males and 97 females for U.S. business, management and technical training, both degree and non-degree. During the same 1986-87 period, 141 agribusiness private sector participants were selected and placed. The Mission plans to expand and broaden this program in 1988-1993. It will more consciously focus both public and private sector training on dealing with problems inhibiting expansion of trade and investment. Taking advantage of Pakistan's highly capable human resource base, the program will explore the potential for expanded training assistance in areas of direct commercial benefit to Pakistan so it may become more competitive both regionally and internationally. These areas which are expected to impact positively on Pakistan's trade and investment prospects will focus to a large extent on new and expanded technology-based enterprises.

## COMMODITIES:

The Mission is actively promoting its Private Sector CIP and trying to provide incentives to private entrepreneurs to participate in the development of the agriculture and energy sectors of the economy. This CIP has $70 million allocated and until recently disbursements were negligible but with lower interest rates and expanded commodity eligibility, participation has increased. Of the $5 million that has been utilized since 1985, 60 percent of this amount has been disbursed in the last six months. At the same time, the Mission's commodity programs supporting GOP activities will continue to offer substantial business for US suppliers. Also the approved applicant banks have recently become more active in the program and projected major advances in commodity procurement.

## E. RELATIONSHIP TO OTHER USG ENTITIES

USAID maintains close and cordial relations with the USDOC Senior Commercial Officer from the Consulate General in Karachi, as well as with the Economic Section of the Embassy in Islamabad. As regards trade and investment, USAID serves as an important source of information on AID and Multilateral Agency projects providing potential business to U.S. firms. The information is initially collected from USAID and disseminated primarily by USDOC and State Officers. Where expert technical information is sought by a U.S. businessman, USAID provides appropriate personnel to do the briefing. Advice on doing business in Pakistan, however, appropriately remains the purview of USDOC and State. USAID can be most effective by directing its efforts to influencing GOP policies facilitating trade and investment as well as through opportunities generated by its various projects.

USAID will seek better coordination of its resources with other.U.S. Government economic assistance agencies, Export-Import Bank, Foreign Commerce Service and Trade and Development. In the recently held USAID-sponsored--First Pakistan National Coal Conference and National Oil & Gas Symposium, USAID involved the U.S. Embassy Economic Counselor staff, USIS and the Foreign Commercial Service (FCS) in a well coordinated program. USAID has continued to use USIS to keep the Pakistan public informed of our energy program and key issues. The Mission continued to work closely with the FCS to promote U.S. private sector opportunities in the energy sector in Pakistan. USAID continues to alert FCS whenever U.S. export opportunities arise and regularly cooperates with FCS on cables to U.S. exporters to supply Pakistan energy equipment importers needs. The Mission spearheaded a successful effort to arrange $250,000 in TDP assistance for a U.S. small hydroelectric power joint venture in Pakistan, continues to support TDP funded feasibility studies such as for an imported coal fired 2,000 MNW power station on the coast and private power projects. The Mission is supportive of a proposed major US-Pakistan energy business conference in the future with the Department of Commerce and proposed that it concentrate on power sector investments in Pakistan, with special emphasis on private power generation and distribution. Under USAID's proposed Private Power Generation and Distribution Project, the mission will continue to use all the above noted agencies and will give special emphasis as well to OPIC and Ex-Im. to facilitate U.S. private sector investment in Pakistan.

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