Strengthening the U.S.-Pakistan Economic Partnership:

Policy Recommendations to the Obama Administration and to Members of Congress

THE SPIRIT OF ENTERPRISE
U.S. CHAMBER OF COMMERCE

U.S.-PAKISTAN
BUSINESS COUNCIL

The U.S. Chamber of Commerce is the world's largest business federation representing more than 3 million businesses and organizations of every size, sector, and region.

The U.S.-Pakistan Business Council is the leading private sector association of U.S. companies with business and investment interests in Pakistan. The council was officially launched at the U.S. Chamber of Commerce on September 2002 to advance U.S.-Pakistan trade and investment relations.

More information on the U.S.-Pakistan Business Council is available at www.uspakistan.org.

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A Message From Myron Brilliant and Jay Collins

On behalf of the U.S. Chamber of Commerce, the U.S.-Pakistan Business Council (USPBC), and our members, we are pleased to present this report to the Obama administration and to members of Congress. Although we recognize the importance of the broader geopolitical relations between the United States and Pakistan, the purpose of this report is to provide the views of the U.S. business community on a range of issues impacting the U.S.-Pakistan economic relationship.

The USPBC is the premier organization in Washington dedicated to the broad advancement of U.S. commercial engagement with Pakistan. Since its inception in 2002, the council has provided a national forum for dialogue on key economic, political, and other issues of interest to American companies operating or exploring business opportunities in Pakistan. The council's membership is made up of small, medium, and multinational companies that export to and invest in Pakistan.

Our members welcome the administration's efforts to develop a comprehensive strategy to bring peace and economic growth to the region. We support the administration's plan to employ a regional approach and to promote Pakistan's economic development while undertaking military and diplomatic initiatives.

A key objective of the USPBC is to strengthen dialogue between U.S. and Pakistani decision makers to expand market access and promote a business-friendly environment for U.S. companies in Pakistan. As the U.S. government develops its comprehensive strategy toward Pakistan, we are pleased to provide recommendations on policies that could help strengthen economic and strategic relations between our two countries.

We want to recognize the contribution of Esperanza Gomez Jelalian in writing this paper and to thank the members of the USPBC for their insights and contributions in formulating these recommendations.

Sincerely,

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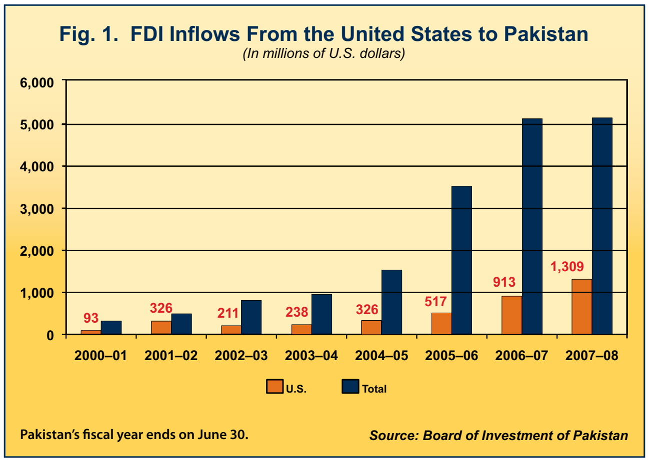
OVERVIEW

U.S.-Pakistan Business Council members recognize that at the center of the relationship between the United States and Pakistan is a shared commitment to improving security and political stability in South Asia. However, we believe that the expansion of bilateral economic cooperation is essential to achieve both countries' security goals. As the Obama administration launches a review of U.S. policy in Afghanistan and Pakistan, the American private sector believes that a broad-based relationship with Pakistan needs to include stronger collaboration in the areas of trade and investment, economic growth, and energy security.



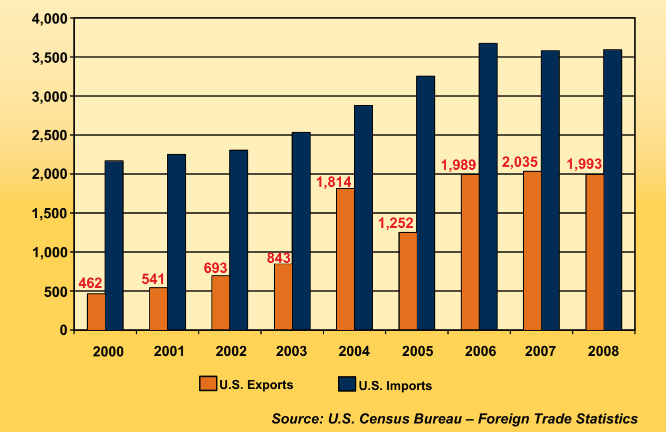
Many U.S. companies have worked in Pakistan for more than five decades and have contributed to the country's economic development through investment and the creation of high-skilled jobs. With a population of 170 million and a labor force of 51 million, Pakistan has a large pool of consumers and workers. The United States has been Pakistan's largest investor, providing approximately one-third of the country's total foreign direct investment (FDI) since 1990. FDI inflows from the United States to Pakistan increased dramatically in recent years from $92.7 million in FY 2000–2001 to $1.3 billion in FY 2007–2008 (see Fig. 1).

Similarly, the United States is Pakistan's largest trading partner. Pakistan's total exports in FY 2007–2008 totaled $19 billion, of which 20%, or $3.7 billion, went to the United States. Trade between the United States and Pakistan has increased significantly in recent years (see Fig. 2). U.S. goods exports to Pakistan rose from $462 million in 2000 to nearly $2 billion in 2008. U.S. imports of goods from Pakistan surged from $2.1 billion in 2000 to more than $3.6 billion in 2008. Total bilateral trade grew to $5.6 billion in 2008, from $2.6 billion in 2001.

Pakistan achieved impressive economic gains from 2002 to 2007, and during that period, annual GDP growth averaged nearly 7%. However, the country slid into a severe economic downturn in 2008. A balance of payments crisis and the government's inability to secure lending and development aid from friendly nations forced Pakistan in October 2008 to seek emergency assistance from the International Monetary Fund (IMF) to avoid defaulting on its sovereign debt.

The IMF approved a 23-month Stand-By Arrangement of $7.6 billion under the Emergency Financing Mechanism to support Pakistan's homegrown adjustment program to stabilize its economy. The initial disbursement of $3.1 billion in November 2008 boosted foreign currency reserves and helped generate

Fig. 2. U.S. Exports and Imports With Pakistan
(In millions of U.S. dollars)



market confidence in relation to Pakistan's capacity to service its debt.

Upon completion of the first review of the program at the end of March 2009, the IMF provided a second tranche of about $847 million. In addition, Pakistan secured $5 billion (over the next two years) in pledges at a meeting of the Friends of Democratic Pakistan and Donors Conference held in Tokyo in April 2009.

Security concerns and the deterioration of law and order in Pakistan have deterred FDI. Investor confidence was further weakened by the bombing of the Marriott Hotel in Islamabad in September 2008, which contributed to the worsening economic situation.

Pakistan also faces an enormous energy crisis. The lack of sustained and affordable energy for the industrial sector, the country's largest energy consumer, has curtailed economic growth and has discouraged foreign investment. Severe fuel shortages and daily power cuts in major cities hinder the manufacturing sector's ability to operate, with particularly harmful consequences for the textile industry. During the last year, protests have occurred throughout the country in response to prolonged power blackouts and rising electricity rates.

Improvement in the access to water resources is critical for Pakistan's economic growth. The country needs to attract foreign investment to build the water storage facilities that its population and industry will need in the next few years.

Pakistan encourages foreign investment for infrastructure development to increase the country's capacity for economic growth. The government is seeking assistance from multilateral financial institutions, bilateral agencies, and private sources for energy and infrastructure development projects.

In 2008, the U.S. business community in Pakistan faced problems created by the country's political uncertainty and deteriorating economy. Despite these challenges, the U.S. private sector remains optimistic about its current investment in Pakistan and sees opportunities for greater engagement in the future.

The U.S. business community recognizes that recent events in Pakistan have forced the government to focus on political stability and national security. Council members believe that stronger and more stable economic relations between the United States and Pakistan would help advance America's overarching geopolitical goals in South Asia.

KEY POLICY RECOMMENDATIONS

U.S. companies appreciate the support that they have received from the departments of Commerce and State in championing American business interests in Pakistan. From the commercial officer to the U.S. ambassador and the secretary of State, backing for U.S. business has been strong. More advocacy, however, for U.S. companies from the White House, others in the administration, and Congress would help American businesses seeking to compete in the Pakistani market.

Commercial Diplomacy and Advocacy

- **Enhance high-level dialogue with Pakistan to deepen the bilateral economic relationship between the two countries.** The U.S.-Pakistan Strategic Dialogue, launched by the previous administration in 2006, served as a mechanism to strengthen bilateral relations in the areas of trade and investment, energy cooperation, and science and technology.

  We urge the administration to promote high-level economic dialogue between U.S. and Pakistan government officials to address bilateral trade and investment concerns. Our organization urges the United States and Pakistan governments to invite the U.S. private sector, including the Pakistani-American business community, to play a constructive role in this dialogue.

- **Advocate on behalf of U.S. companies to ensure a level playing field with their foreign competitors in Pakistan.** With the downturn in the U.S. economy, foreign markets will take on more importance as U.S. companies seek outlets for their products and services. Exports will help retain and increase American jobs and contribute to the recovery of the U.S. economy.

  In particular, the U.S. private sector requests that the administration urge Pakistan to improve the transparency and consistency of government procurement procedures to reflect globally recognized models. At times, Pakistan's current system discourages new investment. Our members request that the U.S. government press Pakistan to adopt measures to ensure that American investors find a level playing field when they invest in Pakistan.

- **Press the international community to help Pakistan attract the financial assistance needed to stabilize its economy in the long term.** According to most estimates, Pakistan will need $10 billion in foreign aid over the next two years. In addition to IMF assistance, the government has secured assistance for infrastructure development projects from the World Bank, the Asian Development Bank, and the Islamic Development Bank.

  The government of Pakistan continues to seek financial assistance from the Friends of Democratic Pakistan nations, which include Australia, Canada, China, France, Germany, Japan, Saudi Arabia, the United Arab Emirates, the United Kingdom, and the United States. Pakistan's ability to raise necessary funds, nevertheless, has become more challenging in the current global financial crisis.

- **Bolster the availability of U.S. Export-Import Bank and other government financing and insurance to stimulate American private sector investment in Pakistan's energy sector.** The government of Pakistan is encouraging foreign investment in a wide range of energy and infrastructure development projects. Although the U.S. private sector has shown interest in many public and private projects, the difficulty in obtaining financing and risk insurance discourages foreign investment in these sectors.

  In recent years, U.S. government financing agencies have played an important role in promoting FDI in Pakistan. The Export-Import Bank (Ex-Im Bank) has offered short, medium, and long-term financing for the export of goods and services to Pakistan's public and private sector buyers. The Ex-Im Bank has also provided export credit insurance to cover exporters against both political and commercial risk.

  The Overseas Private Investment Corporation (OPIC) since 2002 has provided more than $1 billion in financing and insurance for projects in Pakistan, ranging from construction and manufacturing to energy and financial services. Grants provided by the U.S. Trade Development Agency (USTDA) have helped develop Pakistan's renewable energy sector and alleviate the country's current and projected shortage of power.

  The American business community urges the U.S. government to increase resources for finance and risk insurance programs through the Ex-Im Bank, OPIC, and USTDA. Increased funding of these programs would not only foster economic development in Pakistan, but it would facilitate U.S. exports, encourage technology transfer, provide needed investment capital, and allow U.S. companies to manage the risk associated with FDI in Pakistan.

- **Obtain passage of U.S. foreign assistance legislation in the earliest possible time frame.** The U.S. private sector applauds the administration's plan to increase development assistance to Pakistan. Our members support the Enhanced Partnership with Pakistan Act, introduced in the previous Congress by then-Sen. Joe Biden (D-DE) and Sen. Richard Lugar (R-IN), which would triple nonmilitary aid to Pakistan. We are encouraged that Senate Foreign Relations Committee Chairman John Kerry (D-MA) and Ranking Member Richard Lugar (R-IN) have introduced the bill in this Congress.

  The U.S. private sector believes that sustained assistance allocating resources to education, health care, infrastructure development, and poverty alleviation would demonstrate that the United States is committed to ensuring Pakistan's long-term prosperity. The business community welcomes the creation of public-private capacity-building initiatives to help Pakistan's population and provide opportunities for U.S. private sector involvement.

Measures to Strengthen Economic Ties

The U.S.-Pakistan Business Council believes that economic growth and prosperity in Pakistan could provide a path to political stability and security in the region. We urge the United States and Pakistan governments to take steps to encourage increased trade and investment in Pakistan, which would create jobs and new opportunities for U.S. businesses there.

- **Launch a review of U.S. trade policy toward Pakistan and consider cutting tariffs on Pakistan's textiles.** Our members support talks to advance bilateral trade relations through the Trade and Investment Framework Agreement (TIFA) and encourage private sector participation in the process. Although the United States stresses the importance of economic growth in Pakistan, American trade policy fails to provide increased market access for Pakistani products in the United States. American tariffs on Pakistan's leading exports average approximately 10%, about four times the average U.S. tariff rate on imports from other countries.

  The current global recession is affecting Pakistan's ability to increase its exports and investment inflows. U.S. tariffs on textiles undermine Pakistan's ability to compete fairly in the American market. Pakistan also loses out to competitors from other developing countries that benefit from U.S. tariff-reducing preference programs. A reduction in U.S. tariff rates would help Pakistan compete and would allow Pakistani businesses to create jobs, increase exports, and provide a major boost to the country's economy.

- **Applaud the introduction of legislation that would create Reconstruction Opportunity Zones (ROZs) in Afghanistan and the critical border region of Pakistan.** The U.S.-Pakistan Business Council supports the proposal for establishing ROZs contained in legislation that would allow certain goods produced in the impoverished areas along the Afghanistan-Pakistan border to enter the United States duty free. Our members welcome efforts to promote economic development and create market access opportunities to spur growth and improve the standard of living of the local population in Pakistan's border region with Afghanistan.

  We believe that the effectiveness of the ROZs legislation could be greatly enhanced by including products that Afghanistan and Pakistan are capable of making and exporting to the United States, such as cotton trousers and shirts. These products account for more than 65% of Pakistan's apparel exports to the United States, and they constitute more than 27% of all U.S. imports from Pakistan. These products must be included in the ROZs program if it is to provide the broadest possible incentives for companies to invest in these troubled areas. The legislation should also avoid labor-related criteria that would deter companies from investing in Afghanistan and the border region of Pakistan.

The administration should enlist the support of members of Congress in the U.S.-Pakistan economic relationship. In the long term, we ask the U.S. government to explore negotiating a bilateral free trade agreement (FTA), in which Pakistan is interested. Pakistan's leading private sector organizations also continue to make the case for increased market access to the United States. Our members believe that, in the long term, an FTA would help achieve commercial and geopolitical benefits and greater economic integration between the two countries.

- **Work with Pakistan to bolster intellectual property rights protection and urge the government to approve and implement data protection legislation as soon as possible.** Weak protection of intellectual property rights (IPR) in Pakistan remains a serious barrier to trade and investment. The U.S. Trade Representative's Office downgraded Pakistan to the Priority Watch List in 2008, and the country remains on this list in 2009. This move was due partly to Pakistan's lack of progress in implementing legislation to provide data protection for proprietary pharmaceutical and agricultural chemical test data. It was also due to Pakistan's lack of a formal system to prevent marketing approval of patented pharmaceutical products.

  Our members are deeply concerned about the growing menace of IPR violations, evidenced by increasing spurious and counterfeit products. Although Pakistan made substantive progress in 2006 and 2007 on enforcement of IPR violations by closing numerous optical disc pirate plants and taking action against sales of pirated and counterfeit products, book piracy and trademark infringement remain serious concerns. Piracy and counterfeiting hobble investment and innovation, threaten public safety and health, and ultimately shrink government revenue.

  To strengthen the investment climate, the Pakistan government should fulfill its international IPR obligations, including enacting data protection legislation to bring Pakistan into compliance with its obligations under the World Trade Organization's TRIPS agreement. The United States must work with Pakistan to boost IPR protection, including enforcement. We believe that the U.S. government should assist Pakistan in its efforts to enforce IPR protection and promote IPR public awareness by providing training programs for enforcement agencies and customs officials.

- **Urge Pakistan to use competitive pricing and free market principles in setting prices for pharmaceutical products.** The pharmaceutical industry is facing serious pricing challenges in Pakistan that represent a market access barrier for the U.S. private sector. Several American companies are pulling out of or considering pulling out of Pakistan due to stringent government pricing controls, lack of transparency in setting prices, and overregulation in the pharmaceutical sector.

  Pakistan government prices for pharmaceuticals have not been revised since 2001, while the cumulative inflation during this period has been more than 65%. Although the government has considered adjusting prices of pharmaceutical products to compensate producers for devaluation and/or exchange rate fluctuations, no new policy has yet been implemented.

USPBC members request that the Pakistan government work with the pharmaceutical industry to help find solutions that meet the needs of all stakeholders, reward innovation and good manufacturing practices, and contribute to the sustainability of the health care system. Our member companies believe that deregulation, not further price controls, would help achieve the long-term goal of ensuring a fair and transparent system that fosters greater access to medicines. Deregulation would also encourage the development of a strong research and development-based pharmaceutical industry in Pakistan.

- **Emphasize to Pakistan that greater tax incentives would encourage more U.S. companies to establish manufacturing facilities and increase their business in the country.** Pakistan has a high corporate tax rate compared with its neighbors. The council recognizes that the government will need to broaden its tax base to generate the revenue needed to strengthen the economy, improve its infrastructure, and provide much-needed social services. However, at present, the tax burden is carried by a very small base of taxpayers, including foreign investors.

  U.S. investors in Pakistan's beverage sector, for instance, are targeted with higher taxes than domestic companies and those from third countries that manufacture competing beverages such as fruit juices, tea, and bottled water. Carbonated soft drinks are subject to double taxation with a 50% "input" tax levied on soft drink concentrate and a 12% tax on finished carbonated soft drink beverages, in addition to a 16% sales tax.

  The U.S. private sector urges the Pakistan government to provide incentives for foreign investors to manufacture their products locally. High duties on machinery and raw materials, which are not available locally, are a disincentive to companies that want to establish manufacturing facilities. Our members believe that a tax reduction would offer a positive signal to foreign investors that Pakistan's economy is creating a welcoming environment for foreign capital.

- **Conclude a high-standard bilateral investment treaty with Pakistan to bolster safeguards for U.S. investors.** We encourage the administration to pursue the completion of the U.S.-Pakistan Bilateral Investment Treaty (BIT). Both governments initiated BIT talks in 2005 and, although substantial progress was made in 2006, the negotiations remain stalled. Our members believe that a BIT would help create a stable, predictable investment climate to help attract new investment, especially in the critical infrastructure and energy sectors.

  We also urge U.S. officials to emphasize to their Pakistani counterparts the importance of resolving outstanding investment disputes with foreign companies. Fair and prompt resolution of these disputes with U.S. investors would send a signal to potential investors that Pakistan welcomes foreign investment.

- **Ensure a long-term financial commitment to Pakistan to help build its capacity for defense and internal security.** U.S. security assistance activities in Pakistan since 2001 have been critical to ensure that Pakistan remains a steady partner in the war against violent extremists. U.S. assistance has allowed Pakistan's army to modernize its forces and help battle Islamic radicals in the tribal areas. Our members believe that ongoing security assistance programs, including Foreign Military Financing (FMF) and the Pakistan Frontier Corps, are excellent programs on which to build a larger, more comprehensive program to develop Pakistan's capability to defeat extremist groups.

Our members call on the U.S. government to make a long-term commitment in support of Pakistan's defense and internal security capacity building. The year-by-year approach that Congress has sometimes taken in reviewing funding for FMF and Pakistan Frontier Corps programs has been disruptive for government agencies responsible for implementing them. This has also been unsettling for American defense companies responsible for delivering equipment and services under these programs. We urge the administration and Congress to adopt a more consistent and predicable approach.

- **Urge the Department of Homeland Security to provide expeditious approval for nonstop flights to the United States from Pakistan.** Pakistan International Airlines has requested nonstop service from Lahore to New York. The Transportation Security Agency (TSA) has assessed the airport in Lahore to establish its compliance with the International Civil Aviation Organization security standards, which is necessary for nonstop flights to the United States. Although the TSA determined in 2008 that the airport meets the necessary requirements, the Pakistan airline is still waiting for approval from the Department of Homeland Security.

  Our members appreciate the security concerns that need to be considered in approving these flights but ask the administration to provide authorization at the earliest opportunity. Direct flights from Lahore to New York would facilitate economic growth and increased trade and investment links between the two countries.

Looking ahead, the U.S.-Pakistan Business Council welcomes the opportunity to work with the U.S. administration and members of Congress to advance economic engagement with and help develop solutions to commercial challenges in Pakistan. We urge the government to involve the private sector when making policy decisions that could strengthen bilateral ties with Pakistan and advance U.S. goals in South Asia.

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