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Institute of Policy Studies
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Pakistan's Investment Climate: The Way Forward

Seminar Report

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Executive Summary

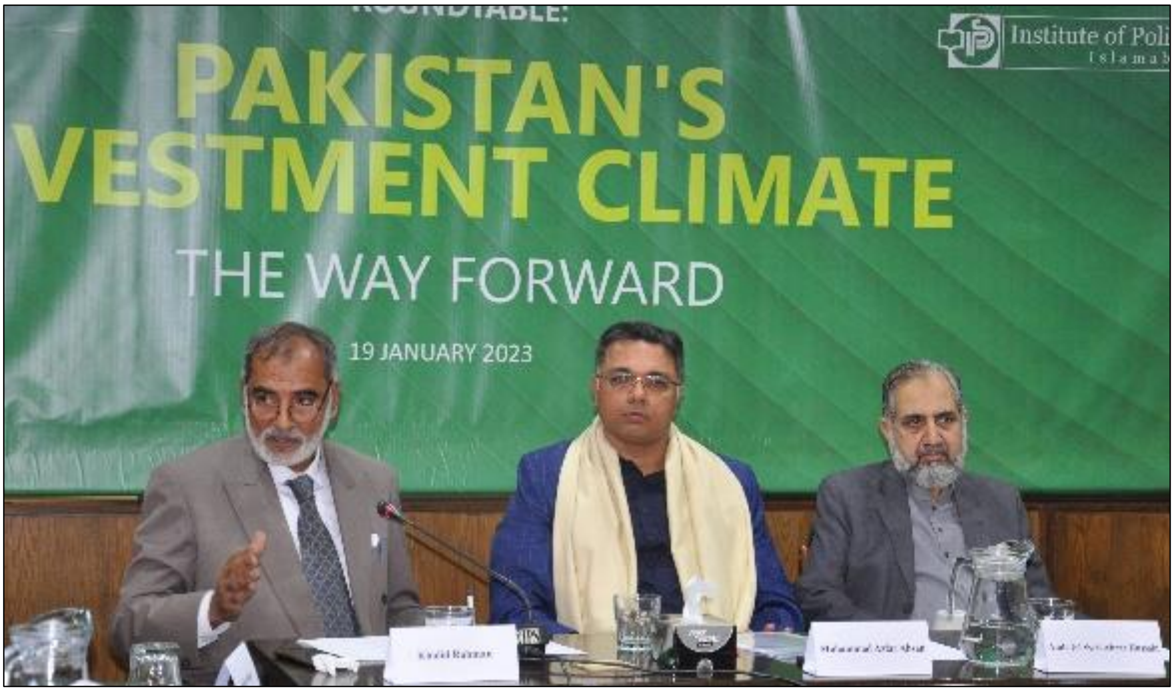
Pakistan's investment climate is one of the most underdeveloped in Asia and has been largely stagnant for the last two decades. In addition to macro threats, several issues pose adverse implications for the business environment in Pakistan. These include uncertainty regarding policy formulation and implementation, corruption at almost all levels of government, incompetence, lack of security and regulatory compliance, insufficient infrastructure, inadequate tax incentives, and a general perception that doing business in Pakistan is risky.

Moreover, investors are losing confidence in the Pakistani market because of the inconsistent economic growth and ongoing balance of payments crisis. The poor system of taxation has increased the current account and fiscal deficits of the country. Consequently, Pakistan's foreign direct investment (FDI) is not adequately thriving to lure in more potential investors.

There is no doubt that some sectors have huge potential but the respective authorities and the government are not prioritizing investments in these areas due to inconsistent policies and a lack of political will. On the other hand, the government is taking various measures under the IMF bailout program. This is further causing investors to withdraw investments due to inflation.

There are several areas in which improvement is required to develop the investment climate so that it is best placed for future growth and development of the economy. Moreover, Pakistan needs to work on various fronts like tackling corruption, policy-making, improving legal certainty through regulatory harmonization, and educating the public on the larger picture.

In order to shed light on the issue, causes, and solutions regarding the investment climate of Pakistan, the Institute of Policy Studies (IPS), Islamabad, held a roundtable discussion titled "Pakistan's Investment Climate: The Way Forward" on January 19, 2023. The session, chaired by Khalid Rahman, Chairman IPS, was joined as keynote speaker by Muhammad Azfar Ahsan, former minister of state and chairman, Board of Investment, while Ambassador (r) Syed Abrar Hussain, Vice Chairman IPS, Syed Tahir Hijazi, former member (governance), Planning Commission, Safdar Sohail, Dean, National Institute of Public Policy, Zafar-ul-Hasan Almas, Joint Chief Economist, Planning Commission, and Dr. Shahzad Iqbal Sham, IPS' Senior Research Associate, also presented their views.



Khalid Rahman, Muhammad Azfar Ahsan, and Ambassador (r) Syed Abrar Hussain

Takeaways from the Roundtable

Q. What are some of the pain points related to the investment climate and potential of Pakistan?

Pakistan's investment climate is complex and faces many challenges. People usually say that doing business in Pakistan is an arduous undertaking, however, the country has a huge investment potential in various sectors of the economy as well. Investors need to be provided support and facilitation. Pakistan can attract billions of dollars locally and from abroad if only there is political stability and investors are facilitated adequately.

- There are several factors that would impact an investor's decision on whether or not to take the plunge and start a business in Pakistan. The biggest pain point is the Federal Board of Revenue (FBR). Tax regulations are inflexible, unclear, ambiguous, and inefficient. The people who fall under the tax net suffer a lot, while the FBR is not even facilitating local investors. There is a huge gap between what the FBR needs and what it promises to provide.
- There are numerous barriers because of the weak Board of Investment (BOI). Government officials and ministers can sometimes be too bureaucratic and slow-moving. There is also a lack of political will and vision from the top levels of the government. One of the main reasons for this is incompetence.
- The absence of a collaborative environment, where experts from both public and private sectors can find solutions and bring about the desired results, is also a pain point that needs to be addressed. Unfortunately, in Pakistan the situation regarding this is bad as several agencies do not collaborate with each other which leads to huge delays in approving projects.
- Massive corruption that is happening at all levels is a major sore spot in the investment climate of Pakistan. After constitutional amendments such as the 18th, there are so many actors involved in decision-making and high politics. Also, there is no accountability by the judiciary; in fact, the judiciary itself is not accountable in Pakistan.
- Another problem is the absence of a rational and sustainable investment strategy. Because of the fact that the government takes up projects without any strategy or mechanism, Pakistan would never be able to attract investors, businessmen, and massive investment; even if this happens, it will not be sustainable.
- Pakistan does not have capital controls; it has an extremely liberal foreign exchange regime that is linked with FDI. The country is on its knees as far as foreign exchange deficiencies are concerned but the authorities are not willing to listen to the imposition of some kind of capital controls under some clearly defined rules yet.
- Pakistan's domestic markets are uncompetitive. There is collusion, monopolies, and cartels; people use even political resources to reduce competition. One reason is bureaucratic hurdles but the biggest reason is that a lot of local investors are thrown out by the lack of competition policies and poor performance of the Competition Commission of Pakistan and other regulatory agencies. As a result, the standards are not there and domestic markets are in a state of capture which discourages a lot of genuine people who want to start a business.

Q. What are the key problems and the reason for the deteriorating investment climate in Pakistan? What is the solution?

All the issues are related to the problem of bad governance. A question that arises here is, who is responsible for governance? On the broader level, governance happens through the prime minister who comes from the parliament. It is up to the politicians to fix this whole mess. They should make it their priority to bring forward such a prime minister who is sincere with the nation and capable of restructuring policies.

Another important issue is unrestrained power of the judiciary; how much the judiciary can use its discretionary powers needs to be kept in check. This can only be done by parliament; judiciary itself will not do it. But unfortunately, people who are elected to parliament either lack the ability or their stakes are very limited (revolving around their self-interest). This means the electoral process needs some changes and parliament needs to elect good people. This way some professionals will come into power who will give priority to national agenda rather than self-interest.

Lack of consistency is a big problem, especially in public policies. This leads to multiple impediments, one of them being a lack of congeniality. There is no collaborative environment even at the local level. On the one hand, there are discussions on linking the country's policies to foreign investment, on the other hand, there is no clarity as far as policy consistency and long-term strategic approach are concerned.

Likewise, there are no measures for creating an enabling environment for investors on the domestic as well as foreign level. A lot of problems have gradually grown into major issues and there is no rectification mechanism. The authorities and stakeholders do not make any effort to make things sustainable. The country's political instability adds to the complexity of the situation as there is no certainty that the politicians, who have to deliver their performance in five years, will be able to complete their term or not.

It is also important to regain the trust of overseas Pakistanis as well as local investors. Although Pakistan does not lack local potential, FDI should remain the focus. Moreover, local indigenous resources should be mobilized, which would help regain the confidence of all stakeholders. This is a simple matter that everyone in the government needs to understand.

In order to bring change in the system, it is necessary to focus on some specific countries and sectors, and ultimately the ecosystem will start working. Last, but not the least, Pakistan should not be dependent on the US, the IMF, the World Bank, or any other international entities. Pakistan should work on becoming self-reliant and a stronger player in global politics.

The investment climate in Pakistan has a political hue and partly unsuitable to attract foreign investors. The current level of economic growth, infrastructure, and business environment needs a lot of improvement. The country needs to take a holistic approach to achieve its full potential and this should be underpinned by better governance, law and order situation, and better tax regime as well as simplification of the process for ease of doing business.

Q. What is the immediate solution to facilitate all the investors interested in Pakistan?

Legislative improvements and strategy formulation are some immediate actions that can facilitate investors interested in Pakistan. Although relevant legislation has been formulated, and it is a big volume, it is not available in an updated form.

On the other hand, countries like Turkey have all their laws related to imports, exports, investment, etc. in a compiled form. During the era of prime minister Necmettin Erbakan (1996-97), Turkey constituted a board and formed a special team whose sole job was to ensure correspondence regarding the compiled data before passing any law. This happens in every government office in Turkey.

So, one of the biggest problems in Pakistan is that thousands of laws are all over the place but no one knows which laws apply where. The roles of a lot of institutions overlap and there are no compiled laws, as a result foreign investors become confused and are hesitant to invest. The immediate step that can be taken is to constitute a forum to compile all the laws. It would eliminate all the legal complexities and contradictions.

Q. What are the other reasons that countries in the region are successful in attracting investments but Pakistan is lagging?

Unfortunately, Pakistan has become an outlier in the region at this point. India, Bangladesh, and other East Asian countries have been way more successful in attracting investments. During the current balance of payments crisis, Pakistan only has two options; to increase investment and to increase export. And for both of these, improvement of the production center is necessary, especially in the regulatory section.

In the case of China, the contribution of their non-residents has played a huge role in investments. If remittances are coming to India, then again besides multinational companies there is a huge role of non-resident Indians. So the problem with Pakistan is that it has an incentive structure only in real estate; there is no entrepreneurship culture.

Then comes the problem of regulations and red-tapism. As long as the unnecessary regulations prevail, there will be an administrative burden on investors which will lessen their interest ultimately. Pakistan has a lot of restrictions and a system of hurdles because of outdated procedures and a system left over from the 18th century. With this outdated system, the country cannot improve its exports nor can it attract investments.

Pakistan's regulatory system is not positive towards new investors and does not focus on facilitation but rather on restrictions. So, when an investor comes and buys assets, all relevant institutions spring into action to impose restrictions. Contract enforcement, judiciary, and bureaucratic system all require various changes. If an investor can invest in India, he can also do so in Pakistan but all the above mentioned hurdles come in the way.

Vietnam and Pakistan had equal exports ratio in 2001 but now Vietnam has diverse exports because of best practices and a strategy that facilitates investors. The officials should compare and evaluate what best practices Vietnam and other countries had adopted that Pakistan has not been able to embrace. The government should run a comparative analysis with similar countries to identify their good points and formulate policies accordingly. For this purpose, both technocrats and bureaucrats need to work side by side. Most importantly, outdated processes need to be reviewed because time and interests have changed.

Q. What role can the Board of Investment play in improving the investment climate of Pakistan?

Foreign investors come to a country to generate profits and in return for their investment they seek concessions, securities, or protections. So it would be counter-productive if the authorities entangle them in various contracts and restrictions. On the other hand, there is the local value added to that investment which usually could be seen as technology transfer, transfer of management practices, or use of local, natural, or human resources.

If investments are market-seeking, resource-seeking, or export-oriented, a country has to decide what kind of incentive burden it is willing to take upon itself vis-à-vis the addition to local value. But the BOI does not take into account this equation, i.e. which entity came to Pakistan and with what objectives, what kind of incentives they were given and what was the overall situation? Usually the BOI uncritically accepts figures that are presented to it. The incentives and other matters are decided on the basis of these figures. A lot of times, this creates distortions between the local investor, who does not enjoy those kinds of incentives, and the foreign investor. The BOI should address such issues by updating its investment management policies.

Also, the BOI should not be given regulatory powers or, if assigned such powers, these should be exercised properly.

Moreover, regarding attracting investment, even a small country like Sri Lanka has a clear strategy of directing investment through the modular provision of incentives that if the investments would have positive externalities in terms of environment, investors would get more incentives. On the other hand, Pakistan's automobile sector along with many other sectors are still in the category of infant industry and continue to enjoy all the benefits that were given to them decades earlier.

There are many issues with the regulatory side of foreign investments. A glaring example is that of Nestlé. In Pakistan, the prices of Nestlé products are double compared to in India although the products are more or less the same in both countries. This is due to issues on the regulatory side. These multinational companies indulge in such practices which should be known to the BOI and need to be curbed. An active role on part of BOI is the vital need of Pakistan's investment climate.

Q. What role bureaucrats can play in the investment climate of the country?

There is a crucial role of bureaucrats in attracting investments to a country. From solving the problem of ad-hocism to providing facilitation to investors, all are part of the job of bureaucrats. But their lack of motivation and incentives to work is the real dilemma. A government servant in Pakistan has no motivation as he gets promotions after long durations and motivation starts wearing off soon after thinking about retirement. The federal government employs more than 400,000 clerks (from grades 1 to 16) who have little to no actual work. Their job description revolves around moving files from one place to the other or maybe some drafting. If the government abolishes such posts and just focuses on the professional ones, billions of rupees can be saved.

Another problem is that the total number of technocrats in the federal government is 20,000 and the total number of bureaucrats who enter service through CSS is 750 approximately. Whichever position becomes available in Islamabad (irrespective of the fact that whether an expert in welfare, investment, accounting, or finance is needed), one of those 750 bureaucrats gets appointed who has no technical expertise related to that post. By the time someone understands how things work, they get transferred.

So this whole issue of no decision-making for or facilitation of investors boils down to government servants. Besides, the lack of stability of bureaucrats keeps Pakistan from becoming an investment-friendly country. The reasons for this are:

- Lack of incentives
- No set targets for civil servants
- No performance evaluation
- No system of reward and punishment

Some time ago, a report showed that in the last 32 years not even a single officer of the KPK government was terminated due to corruption and inefficiency. It is impossible that there could be zero corruption by civil servants during all those years. Even in a developed country like Japan, every year 500 to 1,000 people get fired on these charges. When Japan specifically targeted corruption in the previous years, around 5,000 employees were fired.

In Pakistan, there is no system of performance evaluation, hence no one talks about the efficiency of officers. Performance evaluation is the key in the corporate world. In the private sector, targets are assigned at the beginning of the year, and at the end of the year, performance is evaluated and decisions made whether employees should get promoted, rewarded with a bonus, or fired. Pakistan's government lacks this system. As long as this problem is not addressed, things will not get better.

Only when these matters will get regulated and everyone will be provided with incentives, everything will run smoothly or with much fewer problems. The respective authorities need to sit down and focus on structuring the human resource management system. When such steps will be taken, investments will start arriving automatically.

Q. Is there any case study in terms of investment that can serve as an example or model for Pakistan?

Currently, Saudi Arabia is a hub or center point of global investments. The way the country has built itself and emerged as a center of investment is a good example for Pakistan. The Saudi public investment fund is the world's third largest official fund consisting of $620 billion. And public investment is a part of the Saudi Vision 2030.

Saudi Arabia is always looking forward to investing in countries around the world, and, in Pakistan, the Saudi government is particularly interested in the fields of renewable energy and agriculture and want to invest in many other specific sectors as well. But unfortunately, things do not get finalized on part of Pakistan.

There has been some improvement in this regard as Pakistan built an investment strategy with Saudi Arabia and a concept of "one team" was put forward. There was a clear signal from Crown Prince Mohammed bin Salman to his family business houses that they should keep Pakistan in their focus and indicated to work with Pakistan on agriculture and engage the country as a food security partner.

By looking at stronger case studies in the investment field, Pakistan can understand that it needs to start focusing on G2G (government to government) relations as well as G2B (government to business) and B2B (business to business). There are a lot of countries and investors who can invest in Pakistan. If the government works on a B2B basis, things will get done faster as B2B interaction not only builds confidence on both sides but also creates a spillover effect. If the government finalizes three investments with a country, 30 more investors will be attracted. And if a single investment deal is ruined, 30 other investors will turn away. It is not hard to understand that bringing a change in the investment climate is vital; follow-up and commitment are needed.

Q. Despite all the hiccups, Pakistan has a huge investment potential. What could be the way forward?

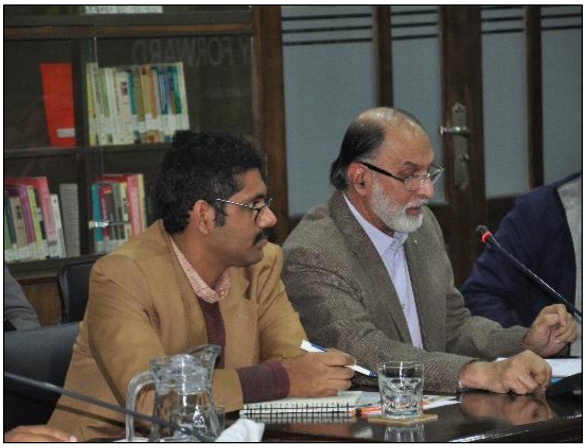
Pakistan offers huge investment opportunities in various sectors of the economy. In a report, recently published by the Organisation of Islamic Cooperation, Pakistan has been declared a better marketplace than India, proving that the country is no less than any other and has the inherent capacity to build a prosperous economy.

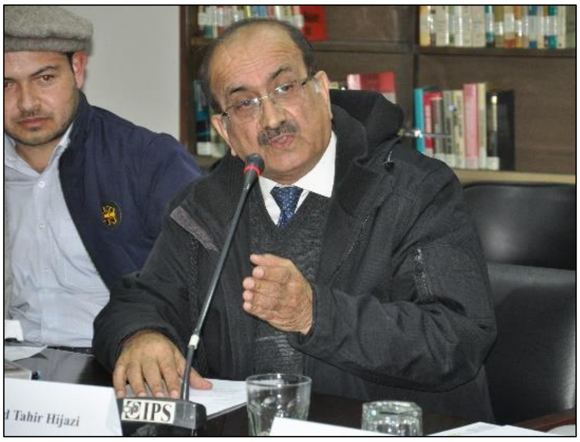
The investment potential of Pakistan can be determined by a range of key factors. These include the country's strategic location as it is a gateway to some of the important regions like the Middle East, South Asia and Central Asia, thus making it an attractive destination for foreign investors looking to have access to these markets, presence of abundant natural resources like gas reserves and minerals as well as its significant consumer market and, most importantly, its young bulge.

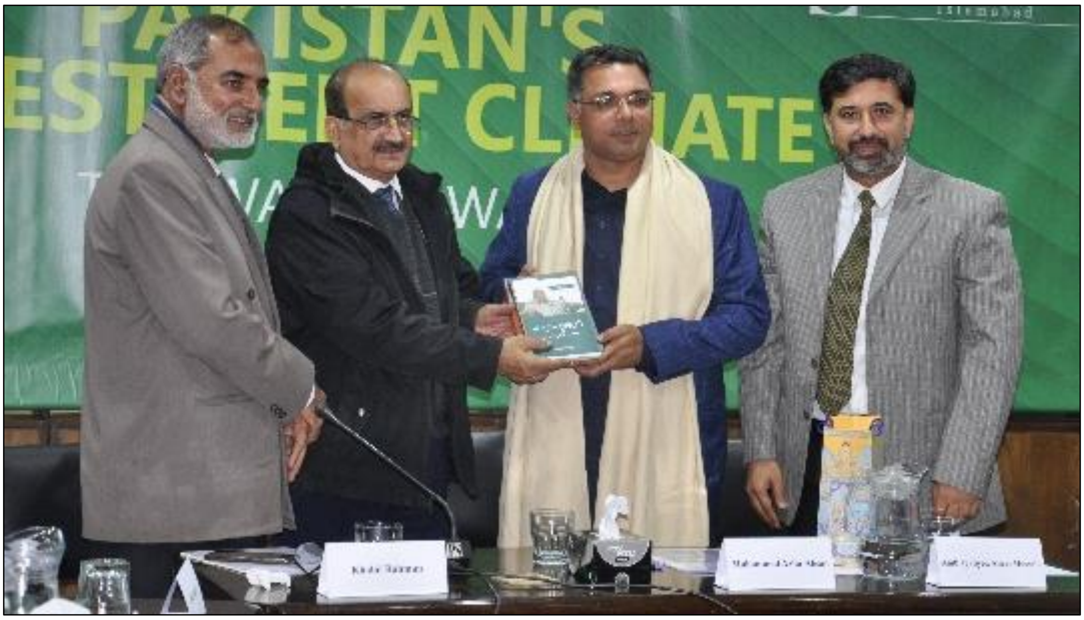
Pakistan can easily tap its potential in the manufacturing sector. Since the country gets most of the raw materials from other countries, there is a great space for procuring a number of raw materials locally. This would not only help the country in becoming self-sufficient but it will also increase exports. For that, Pakistan can acquire the required technology. Moreover, there is a lot of potential in the mining sector as gold, coal, and other earth elements are found in vast quantities in the country. To tap into this potential, Pakistan needs to formulate a suitable policy, create awareness among stakeholders to encourage exploration, and collaborate with national and international partners.

Pakistan has latent opportunities worth billions of dollars in other industries as well. It possesses the requisite capacity and capability and if it just focuses on six to eight countries and stays consistent, it can easily attract FDI worth several billion dollars from those countries alone. As such the country has the potential to attract $15 to $20 billion in FDI within the next three to six years. However, to unlock this huge investment Pakistan has to develop a conducive and feasible environment for investors.

Picture Gallery







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