3 PROSPECTS OF INVESTMENT FOR MNCS/ INDIAN INVESTORS IN PAKISTAN

Like other developing countries, foreign investment in Pakistan, whether through transnational corporations or other forms, is being widely considered as an important vehicle for economic growth. Pakistan has introduced a wide range of incentives, congenial for both local and foreign investors and has increasingly tended to turn to foreign direct investment (FDI) as a source of capital, technology, managerial skills and market access needed for sustained economic development. The country provides a one-window facility for setting up business, and foreign investment is fully protected under law, including avoidance of double taxation. The reorientation in policies designed to attract more FDI, has been accompanied by the adoption of policies relating to privatization and deregulation of economic activity and greater reliance on market forces in the country. Pakistan's recent economic reforms offer unprecedented and conducive business opportunities to all MNCs including Indian-based investors. Pakistan is now one of those countries in the region whose reforms and economic achievements during the last few years have steered the country to a business-friendly environment, creating a win-win situation for both investors and consumers.

Investment by MNCs promotes the transfer of technology and expertise, which in turn stimulates the economic growth of developing countries. Encouraged by such facts, host countries offer various incentives to MNCs which include but are not limited to tax breaks, liberal rules and regulations, special grants, etc. Investment in electronics and other high technology industries is widely seen as especially desirable in developing countries like Pakistan, given that it provides employment opportunities, boosts exports by increasing production and helps in modernizing the economy.

This chapter provides an overview of investment opportunities, potential areas of mutual cooperation between Pakistan and India and Pakistan's foreign investment policy, etc. Detailed analysis identifying cost & benefits of investment in particular areas require an in depth study which was beyond the scope of this report. However, opportunities and threats in some important sectors which are likely to emerge by the opening up of trade between the two countries are covered in Chapter 4.

Potential Areas for Mutual Investment

Multinational corporations (MNCs) are at the heart of debate over globalization and its impact on developing countries. Advocates of global economic integration invariably emphasize the crucial role of multinationals in providing the much-needed capital, jobs, and technology for poor nations. Pakistan offers potential opportunities to foreign investors (including investors from India) and MNCs when seen in the context of its strategic location at the crossroads of China, Central Asian Republics (CAR) and Gulf States. It has an easy access to markets of Iran, Afghanistan, CAR and Middle East. A lot of incentives for investors especially with respect to tax and regulations relating to repatriation of capital and profit have been provided in the foreign investment policy. Almost all the exchange restrictions have been removed and the country has attempted to open up its economy for foreign investment. Adequate legal framework for foreign investment has also been provided in the form of Foreign Private Investment (promotion and protection) Act, 1976, and the Protection of Economic Reform Act, 1992.

Potential Joint Ventures (JVs) between India and Pakistan

As India and Pakistan compete to sell their goods in the global market, there are many areas in which both the countries can complement each other’s needs and hence produce cost-effective quality goods. The Board of Investment has indicated that Pakistan has so far made bilateral investment agreements with 46 countries (except India) during the period from 1959 to 2004.[31] At present, joint ventures between the two countries are non-existent, and so is direct investment. Taneja’s paper also points out that there still aren’t any Indo-Pakistan joint ventures in spite of strong business interest on both sides due to the absence of an enabling environment for such investment.[32] For example, there are no institutional mechanisms for bilateral investment guarantees. There is considerable lack of information and awareness in India about Pakistan’s trade regime, commercial policies and business and regulatory procedures. It identifies investment possibilities in Pakistan in sectors such as fish processing, chemicals and pharmaceuticals, automobile components and information technology. The IMF Country Report for December 2004 on Pakistan also indicates that FDI flows both to India and Pakistan have been rather low during the period 1990-2003. In India, FDI inflows remained below 1 percent of GDP, while in Pakistan, these fluctuated between 0.6 percent and 1.4 percent of GDP. Low FDI inflows are in part a regional phenomenon, with unweighted country averages in South Asia gyrating around 1 percent. Comparatively, between 1999 and 2003, FDI inflows to Indonesia averaged 2.2 percent of GDP, and were substantially higher for China (3.7 percent). Moreover, FDI flows to Pakistan originating from India are negligible, as is Pakistan’s share in flows to India.

In the recent past, a number of potential sectors for mutual cooperation between India and Pakistan have been identified which inter-alias include: agricultural products, tires, auto spare parts, minerals, chemicals, pharmaceuticals, leather, textile and telecommunications.[33] India and Pakistan can also establish joint ventures to harness

[31] Board of Investment: Investment Policies (http://www.pakboi.gov.pk/).
[32] See footnote 29.
[33] a) “India and Pakistan -- Economic Costs of Conflict”, *The Financial Express*, February 18, 2004;

and transmit the region's hydropower resources. Though Pakistan agreed in principle to export 300 MW of electricity to India in 1998, this cooperation could not be materialized due to a disagreement on tariff rate. Thermal power is the dominant source of energy and accounts for about 73 percent of the installed capacity in India and 69 percent in Pakistan.[34] India has a large reserve of coal (206 billion tones) accounting for about 7 percent of world reserves. Since energy demand is likely to record higher growth in the years to come, there is potential for cooperation between India and Pakistan in electricity generation using coal. India has proven capability in the field of wind energy, with its installed capacity of 900 MW, second only to the United States. There is potential for tapping wind energy in the Sindh province of Pakistan, which could make use of wind power in cooperation with India. Cooperation in water management and power projects can help in increasing irrigation benefits, decreasing risks of floods, and establishing an India-Pakistan electric grid system for intra-country transmission of electricity. Both countries require large volumes of natural gas imports to meet their future domestic needs. A single, joint natural gas pipeline extending overland from Pakistan to India would be economically more viable for both the countries than constructing their respective pipelines independently. Agro-food processing is one of the priorities of most of the South Asian countries. India has made considerable progress in this regard which could exploit its IT knowledge to enhance productivity and to create more knowledge-based food-processing activities. Pakistan is doing well in fresh and dry fruits trade and has made considerable advances in food processing. There is potential to set up modern food machinery design and development centers in India and Pakistan with facilities for design R&D, pilot plant, fabrication workshops and consultancy facilities.

A study commissioned by Federation of Indian Chamber of Commerce & Industry (FICCI) in 2003 has recommended the following areas of potential joint ventures between Pakistan and India:[35]

b) Kumar, 2004.

[34] India Country Note (2004), the World Bank/IMF Annual Meetings October 2004.

[35] South Asian Development and Cooperation Report, 2004, p 50, Chapter 6.

No.	Industry Group	Project Focus
1	**Information Technology**	Software Exports Training Centers: Centre for Software Training & Management (CSTM), Software Development Centre (SDC). Pakistan has the potential to become an important software exporting and training centre. India can become a role model and both the countries should cooperate and collaborate to tap the large global market for software.
2	**Fish Processing**	Processed Frozen/Canned Fish Products: Future thrust should be on exports of value-added canned products to the developed countries.
3	**Drugs & Pharmaceuticals (DAP)**	Bulk Drugs Pharmaceuticals: Expansion of formulation sector (tablets, capsules, ointment, injections, etc.) and expansion of health care products (IV fluids, disposable syringes, diagnostic kits etc.). Indian pharmaceutical industry can provide the necessary support and assistance to Pakistan for the expansion of its Industry.
4	**Agro-Chemicals**	Pesticides Manufacturing unit in Pakistan: With the expansion of agricultural business, demand for agro- chemicals will grow in future. Indian entities can play an important role through transfer of technology.
5	**Chemicals**	Dyes and pigments manufacturing unit in Pakistan has a strong manufacturing base for textiles and leather. Indian entities and multinationals can assist Pakistan in developing the sector.
6	**Automobile Ancillary**	Integrated auto component complex: Next to India, Pakistan is the only country in the SAARC Region to manufacture & assemble Passenger Cars. Pakistan may also consider assembly of HCV & LCV in collaboration with ELCO/ASHOK Leyland from India.

The Research and Economic Development Cell of KCCI in its Report dated February 27, 2004 has identified the following opportunities for investment and joint ventures between Pakistan and India:

- Presently, hi-tech textile machinery industry in Pakistan is non-existent as such the country's whole requirement for BMR expansion is being met through imports. Some of the textile machinery imported from Germany and Switzerland is made under license in India at a much lower cost. It is, however, imperative to establish a hi-tech textile machinery industry in Pakistan as joint ventures with India's leading machinery manufacturers, possibly under buy-back arrangements.
- India is the only country which has naphtha cracking facilities. Pakistan can export naphtha and put up a naphtha cracker plant in collaboration with India. It can export the surplus to other markets in the region after meeting its own requirements of the product.
- The shortage of transport facilities poses a serious problem for intra-regional movement of goods. In this context, NRIs can be approached to establish a direct shipping line between Karachi and Mumbai. For this purpose feasibility of developing Port Qasim as SAARC's last port of call is a good option.

- The Vehicle sector has grown tremendously in India. In view of its increasing demand, Pakistan can benefit from the availability of low priced Indian components instead of importing these items from the Far East.
- Pakistan imports about 4.5 million tons of diesel annually, mostly from Kuwait, but forbids import from India, which exports diesel of more than 5 million tons annually. The import of diesel from India will lower the cost due to lower transportation cost.
- Pakistan is currently wholly dependent on imports of major polymers to feed the demand for petrochemical consumer industries. These items can be imported from India at lower prices because the petrochemical industry is quite advanced in India.

The MNCs operating in India and Pakistan are mostly similar. These can act as meaningful conduits for trade and investment if they source raw material from each other. Vast opportunities exist in the aforesaid areas of common interest, the potential of which needs to be explored. In order to attract export-oriented FDI, Export Processing Zones (EPZs) have long been a popular policy tool in developing countries like Pakistan. The EPZ concept encompasses different types of zones (e.g. free-trade zones, duty-free zones, special economic zones), reflecting the variety of activities performed in them. Despite some variation, export-oriented manufacturing has been the main focus of most zones. Production processes often involve low skills and relatively simple technology, particularly in the garment and footwear industries and in the assembly of electronic components and light machinery goods. While zone firms can be domestic, foreign or joint ventures, FDI generally plays a prominent role. For this purpose, creation of exclusive economic zones in Pakistan for NRIs /Indian based investors may be a good option to attract their investment. At present, the setting up of two export processing zones in Sindh and Punjab have been proposed in the trade policy for FY04-05, while Karachi Exports Processing Zone is being upgraded to provide the maximum possible facilities to exporters to augment exports. The infrastructure and facilities available in the EPZs provide enormous potential for Indian foreign investment which could be utilized to establish joint ventures between the two countries.

NRIs Role in Investment in India

A non-resident Indian (NRI) means a person resident outside India or who is a citizen of India or is a Person of Indian Origin. The general policy and facilities for foreign direct investment as available to foreign companies are fully applicable to NRIs as well. India’s much-liberalized FDI policies have not in the past left enough room for specific policies for NRIs vis-à-vis other non-resident investments, except for the real estate and civil aviation sectors, where 100 percent investment is allowed only to NRIs. They are also permitted to make direct investments in proprietary/partnership concerns in India and also in the shares/debentures of Indian companies. NRIs are currently also permitted to make portfolio investments, i.e. purchase of shares/debentures of Indian companies through stock exchanges in India. These facilities are granted both on a repatriation and non-repatriation basis. NRIs can make investments in domestic public/private-sector mutual funds or money-market mutual funds floated by commercial banks and public/private-sector financial institutions on a non-repatriation basis. There is also no ceiling or restriction on the amount of remittal dividends. NRIs are also allowed to keep deposits in banks in India, the salient features of which are: higher interest rates as compared to banks outside India; the interest earned is non-taxable; the investment, as well as interest on these deposits, is exempt from Indian wealth tax, irrespective of the amount. And the principal and interest can easily be repatriated.

During the past five years India's FDI policy has become appreciably liberal. The very fact that Indian intellectual capital is so admired world-wide has a lot to do with the success of Non Resident Indians (NRIs). Not only have Indians earned accolades for entrepreneurship, Indian doctors, scientists and engineers have enjoyed a position of eminence in the countries they have chosen to seek their fortunes in. India is now one of the most preferred outsourcing locations, from low-value-added to high-value-added services, as well as products. Not only this, between 1999 and 2003, the number of patents granted by the United States Patent & Trademark Office to Indian entities increased by 210 percent to 338.

Countrywide data provided by the Indian government for FDI approvals shows the increasingly important role played by NRIs over the past few years. As per available information, NRIs stood fifth on the list (with total intended investment of Rs 110 billion [US $2.4 billion], a little less than that of Japan at Rs 118 billion, with the US at the top with Rs 581 billion) of cumulative FDI approvals for all countries in India since 1991 (when India's reforms process started) until 2003. NRIs aiming to bring more investments into India than countries such as Germany, France and the Netherlands, etc., can hardly be considered non-reliable. What is more heartening is that, in recent years, proposed NRI FDI in India has improved in the face of falling approvals from major investing countries. For example, while NRIs were ninth in the list in 2002, they climbed to third in 2003. Even in terms of remittances, NRIs are a group to reckon with. India topped the World Bank's list of workers' remittances at $10 billion in 2001, which was more than 13 percent of the total $72.3 billion for all developing countries during 2001. NRI remittances at about $14.8 billion in 2002-03 were almost 3 percent of the country's gross domestic product. Over the years, NRI remittances have helped the country offset its merchandise trade deficit in a significant measure, thereby keeping current account deficits at a modest level through the 1990s and posting modest surpluses in 2001-02 and 2002-03. [36]

[36] "India sees the value of its NRIs" by Kunal Kumar Kunda, ASIA TIMES Online, July 9, 2004.

Investment Opportunities for NRIs in India[37]

In India, the investment options for NRIs are dependent on their account status which is given in the following table.

Snapshot of Various Accounts

Deposit A/c	Currency	Repatriability
Non-resident external NRE	Options Rupee (INR)	Both the principle and redemption proceeds are repatriable
Non-resident Non-repatriable NRNR	Rupee (INR)	Both the principle and redemption proceeds are not repatriable
Non-resident ordinary NRO	Rupee (INR)	Both the principle and redemption proceeds are not repatriable
Foreign Currency Non Resident FCNR	USD, GBP, DEM, JPY, EURO	Both the principle and redemption proceeds are repatriable

- **Mutual Funds:** All types of schemes including diversified equity funds, Balanced Funds/ Debt funds, Govt. Securities Funds/Money Market funds.
- **Fixed Return Instruments:** Company Fixed deposits, Bonds of Central & State Govt. companies, Debentures and Government's saving schemes.
- **Fixed Deposit Schemes:** Indian companies, with highest credit rating on repatriation as well as non-repatriation basis.
- **Bonds issued by leading financial institutions:** IDBI, ICICI and bonds of Central and States Govt. undertaking. Investments in Government Savings Scheme like Public Provident Funds and National Savings Certificates. Investment allowed in selected initial public offerings (IPO) of emerging companies in the fields of Banking, Petroleum, Auto and other Growth Sectors.

Investment without Repatriation Benefits

- Investment in Mutual Funds schemes without any limit.
- Deposit with firms and companies without any limit.
- Portfolio Investment in Equity/ Convertible debentures through Stock Exchange allowed with a limit of 10 percent total paid-up capital. Company may resolve by General Body resolution to allow NRI/OCBs to share up to 24 percent. Individual NRI investment limit is 5 percent for single investor in a company.
- Portfolio investment in preference shares/non-convertible debenture Master shares of UTI without any limit.

[37] Investment Options for NRIs in India, Bajaj Capital; (http:www.bajajcapital.com/nri/nri.html).

- Investment in new issues of equity/preference shares allowed without limit except companies engaged in plantation, agriculture or real estate business, *chit* fund and *Nidhi* companies.
- Investment in non-convertible debenture of Indian companies without any limit.
- Immovable property without any ceiling.
- Investment in firms engaged in any industrial, commercial or trading activities without any limit. OCBs are not permitted.
- Units of Unit Trust of India, Centre and State Government Securities, National Saving Certificates.
- Investment in Commercial Papers without any limit and OCBs not allowed.

Investments with Repatriation Benefits

- Domestic Mutual Fund Scheme in public/private sectors without any limit.
- Deposits with companies without any limit.
- Investment in Units of UTI, Central/State Government Securities, NSC without any limit.
- Portfolio Investment in Equity. Purchase of shares by a single investor in one company not to exceed 5 percent of its paid-up capital. The aggregate limit for total NRI investment in a company should not exceed 10 percent. Aggregate limit can be raised to 24 percent with resolution by General Body.
- Portfolio investment in executing non-convertible debentures and Master share of UTI without any limit.
- Investment in new issues of shares of a company engaged in manufacturing activity with 51 percent limit.
- Investment in 100 percent export oriented units and units in export processing zones without any limit.
- Investment in Priority sector industries within specified limit.
- Investment in Housing and Real estate development without any limit.
- Investment in bonds issued by Public Sector Undertaking without any limit.
- Investment in companies and firms engaged in financial, hire purchase, leasing, trading or other services up to 25 percent of the paid-up capital.

Pakistan’s Foreign Investment Policy

Salient features of Pakistan’s Foreign Investment Policy include:

- All economic sectors are open to FDI.
- Equal treatment extended to local and foreign investors.
- 100 percent foreign equity is allowed on repatriation basis.
- No government sanction required.
- Attractive tax / tariff incentives package.

- Remittance of royalty, technical and franchise fee, capital, profits, dividends allowed.
- Foreign investment is fully protected under: a) Foreign Private Investment [Promotion & Protection] Act, 1976; b) Protection of Economic Reforms Act, 1992; and c) Foreign Currency Accounts [Protection]) Ordinance, 2001. In addition Bilateral Agreements include: Investment Protection with 43 Countries and Avoidance of Double Taxation with 51 Countries.

Industry-Wise Policies and Incentives

Manufacturing/Industrial Sector

- Foreign investors are permitted to hold 100 percent of the equity of industrial projects without any permission of the government.
- No government sanction is required for setting up any industry, in terms of field of activity, location, and size, except arms and ammunitions, high explosives, radioactive substances, security printing, currency and mint and alcoholic beverages or liquors.
- There is no requirement for obtaining No Objection Certificates (NOC) from the provincial governments for locating the project anywhere in the country except in areas that are notified as negative areas.

Non-manufacturing/Industrial Sector

- Under foreign investment, 100 percent equity on repatriation basis is allowed in the Service, Infrastructure, Social and Agriculture Sectors subject to the conditions indicated against each.

- Registration of company with Securities and Exchange Commission of Pakistan (SECP) under the Companies Ordinance, 1984, is required under intimation to the State Bank of Pakistan.

Services Sector

- FDI in Service Sector is allowed in any activity subject to the condition of prior permission/NOC or license from the concerned agencies and to provisions of respective sector-wise policies.
- 100 percent foreign equity is allowed on repatriation basis.
- The minimum amount of foreign equity investment in the company/project is US $0.15 million. SRO 457(I)/2004 dated 12.06.2004 contains the list of deregulated services in telecommunications.

Infrastructure Sector

In the infrastructure projects, including the development of industrial zones, 100 percent foreign equity is allowed on repatriation basis. The minimum amount of foreign equity investment in the company/project is US $0.3 million.

Social Sector

100 percent foreign equity is allowed in education, technical/vocational training, human resource development, and hospitals, medical and diagnostic services. The minimum amount of foreign equity investment in the company/project is US $0.3 million.

Pakistan's Competitive Investment Package

	Manufacturing Sector Priority Industries				Non-Manufacturing Sectors		
	V.A + Export Cat (A)	Hi-Tech & IT Cat(B)	Engg+ Chem., Agri business, housing & construction, tourism Cat (C&D)	Other Indus-tries	Agriculture	Infrastruc-ture & Social	Services including IT & Telecom Services
Govt. permission	Not required except 4 specified industries *				Not required except specific licenses from concerned agencies.		
Remittance of capital, profits, dividends, etc.	Allowed				Allowed		
Upper limit of foreign equity allowed	100%				60%	100%	Initially 100% but to be diluted to 60% within 5 years.
Minimum investment amount (M $)	No				0.3	0.3	0.3
Customs duty on import of PME	5% **	5%**	10%**	5-25%	0% ***	10%***	0-10%***
Tax relief (IDA, % of PME cost)	50%				50%		
Royalty and technical Fee	No restriction for payment of royalty & technical fee				Allowed as per guidelines - Initial lump - sum up to $100,000 Max Rate 5% of net sales - Initial period 5 years		

Following incentives are available to both foreign and local investors:-

1. Custom duty of 5 percent chargeable on import of plant, machinery and equipment, not manufactured locally.

2. Zero rated sales tax on import of plant, machinery and equipment under Notification No. SRO: 500(I)/2004 dated 12 June 2004.[38] Locally manufactured plant, machinery and equipment are also exempted from payment of sales tax.
3. As per SRO: 455(I)/2004 dated 12 June 2004, plant, machinery and equipment, imported under SRO: 439(I)/2001 dated 18 June 2001, under the category of export industry and having failed to achieve targets of exports as specified or exercises the option to forego the benefit of duty concession at post import stage, in excess of customs duty at the rate of one percent per year of default with a maximum of 5 percent of dutiable value at the time of import provided the period of import is equal to or more than five years.

[38] Central Board of Revenue (CBR) website: www.cbr.gov.pk.