ASIA HOUSE

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BUSINESS IN PAKISTAN

Pakistan: A land of emerging opportunities

Last year, Danish goods exports to Pakistan increased by 57%, making Pakistan Denmark's fastest growing market in Asia. The total Danish exports to Pakistan in 2016 reached DKK 790 million, higher than Bangladesh (DKK 610 million) and approaching the level of Indonesia and The Philippines (DKK 920 million).

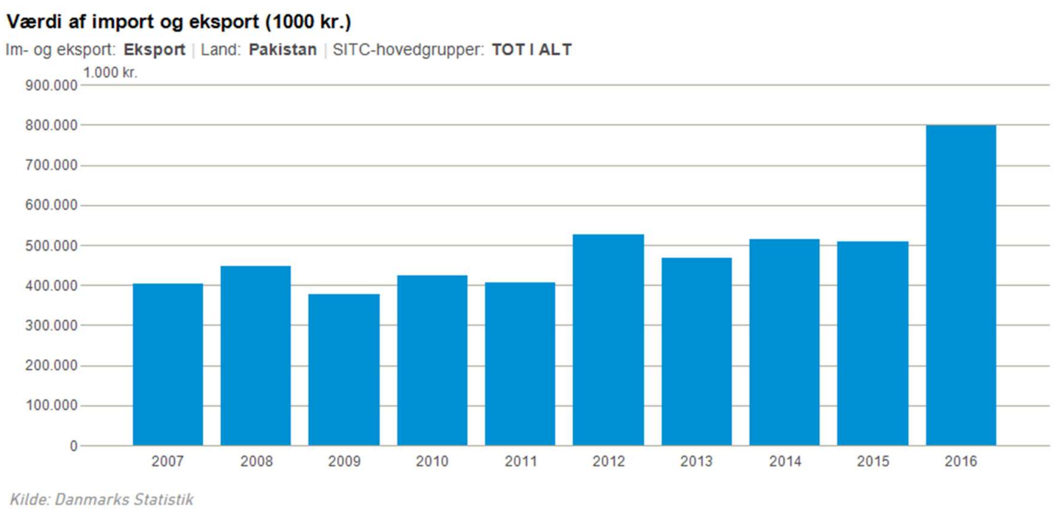
Behind this apparent success lies a more ambiguous story of both great and lost opportunities. According to UN statistics, Sweden exported three times more to Pakistan than Denmark in 2016. Belgium nearly eight times more.[1]

The purpose of this Asia House Briefing is to shed light on the economic engagement with Pakistan: The pros and cons, opportunities and obstacles, trends and realities. The briefing also serves as a precursor for the upcoming seminar on *Business in Pakistan* in December at Asia House.

Denmark in Pakistan

60% of Danish exports to Pakistan were classified as machinery and pharmaceuticals, which also accounted for the main areas of growth: Machinery nearly tripled in value from DKK 124 million to DKK 350 million, while pharmaceuticals increased from DKK 78 million to DKK 124 million. In fact, two thirds of the growth from 2015-16 came from these two sectors.[2]

Most likely the Danish success in Pakistan in 2016 was based on a few big orders, notably FLSmidth's DKK 675 million contract for delivery of a complete cement factory three hours' drive from Karachi.[3] Thus, the great increase in Danish exports from 2015-16 does not necessarily reflect a greater Danish engagement in Pakistan on a broader scale.



FLSmidth is one of Denmark's most established companies in Pakistan, but many large Danish companies are present in Pakistan, either directly or through a Pakistani partner, e.g. Novo Nordisk, Novozymes, Maersk, Grundfos, Danfoss, Rambøll, Lundbeck, AVK, DSV and Damco.

However, changes within Pakistan are creating new patterns of demand, and thus new opportunities. A growing middleclass is demanding high quality processed food, not just imported from abroad, but also produced by domestic companies. FOSS, providing solutions for food analysis and food control, has successfully tapped into these new opportunities. In 2016 they doubled their sales in 2016 and expect the trend to continue in 2017.[4]

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[1] United Nations COMTRADE database on international trade

[2] Danmarks statistik

[3] Børsen, 29/5-2017: *FLSmidth lander storordre i Pakistan*

[4] DI Business, 17/11-2016: *FOSS: Pakistan elsker danske varer*

In November 2016, The Confederation of Danish Industry (DI) and the Danish Embassy in Islamabad tried to capitalize on these opportunities, and organised a Food and Agribusiness delegation to Pakistan for seven companies.[5]

Another sector showing potential in Pakistan is Information Technology. Though often overshadowed by India, Pakistan has one of the strongest programming communities in the world with 10,000 IT graduates entering the market every year and an estimated 1,500 software active companies. Danish Ciklum has tapped into this resource and now provide IT-solutions for a range of European customers by Pakistani developers. Another start-up, Vopium, providing IP-communication, is another success-story.

The Security Issue

The main narrative coming out of Pakistan the last 15 years has been one of terrorism and insurgency. Indeed, the British Governments travel advice for Pakistan makes sombre reading: *"There's a high threat of terrorism, kidnap and sectarian violence throughout the country, including the cities of Islamabad, Rawalpindi and Lahore… Foreigners, in particular westerners, may be directly targeted. Densely populated unsecured areas, such as markets, shopping malls, restaurants and places where westerners and the Pakistani elite are known to congregate, are potential focal points for attacks".* Nonetheless, the summary ends on a positive note*: "Around 270,000 British nationals visit Pakistan every year. Most visits are trouble-free*".[6] Often visitors to Pakistan are positively surprised by the ground realities.

The security situation in Pakistan has improved radically since 2014, when the military launched a major operation against insurgents and terrorist organisations. According to the British magazine The Spectator "*Violence… is down by three quarters in the last two years. The country is safer than at any point since George W. Bush launched his war on terror 15 years ago.".* Yet *"it fails to fit the established narrative of Pakistan as a dangerous nation (and thus has) gone unacknowledged in the West.".*[7]

The number of terrorist-related civilian deaths have dropped from 3,000 a year in 2013 to 600 in 2016, with most of the casualties found in the Baluchistan and Khyber Pakhtunkhwa along the Afghan border. During the same period – 2013-16 – the number of terrorist bomb blasts in Karachi dropped from 51 to 2 a year.[8]

Recently, the Danish Ministry of Foreign Affairs lowered the risk assessment for Pakistan, allowing for "necessary trips" to most parts of the country.[9]

Pakistan in transition

Despite the improving security situation, Pakistan is still categorised with the lowest possible credit rating by OECD and the Danish export credit fund, EKF. Pakistan is rated 7. Nepal and Sri Lanka: 6. Bangladesh: 5. India: 3. There are several reasons for this negative rating, and several reasons why the situation seems to be improving.

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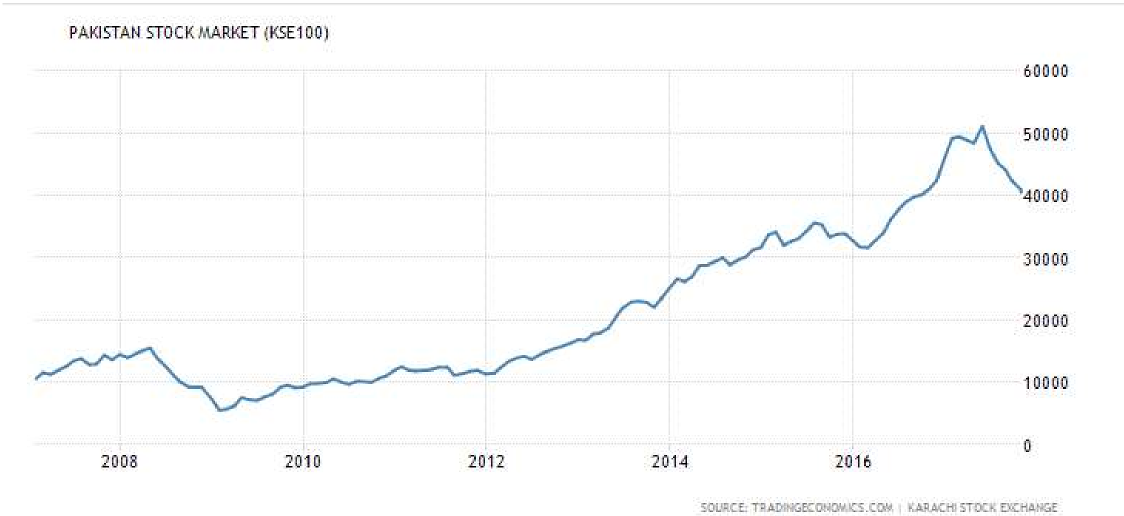
[5] The Confederation of Danish Industry, *Food and Agribusiness, 14-18 November 2016*
[6] www.gov.uk/foreign-travel-advice/pakistan (updated 25/10-2017)
[7] The Spectator, 31/12-2016: *Pakistan is winning its war on terror*
[8] Dawn, 20/7-2017: *Terrorist attacks in Pakistan continue to decline: US report*
[9] Finans, 25/5-2017: *Pakistan har gjort op med terroristerne* (af Christina Petersen, Analytiker EKF)

Political stability: Pakistan has been marred by military rule and political turmoil for decades. The civilian governments have often been weak and instable, and influenced by vested interests from powerful families and the military establishment. However, during the last 10 years Pakistan has experienced a new political stability, with governments completing full five-year terms and handing over the reins of power in a peaceful manner. Next general election is planned for 2018.

Economic development: Pakistan's economy has been characterised by weak economic growth, a high budget deficit and a negative trade balance, which has depleted the foreign currency reserves and weakened the Pakistani rupee. This – of course – has been a source of concern for investors, both domestic and foreign. But things are changing.

For the past three years the government has managed to restore macroeconomic stability. The budget deficit has been trimmed, mainly by increasing tax revenue and cutting energy subsidies. Low oil prices have reduced Pakistan's trade deficit and allowed it to rebuild foreign-exchange reserves.

Growth rates for 2017 are expected to climb to 5.2 %, the highest in nine years, and forecasts for 2018 and 2019 are even higher: 5.5 % and 5.8 % respectively. Part of the growth is due to textile production moving from China to Pakistan due to lower wages (though Bangladesh remains a tough competitor). The positive tendencies are to some extent reflected on the Pakistani stock market:



The steep increase early 2017 was partially fuelled by the upgrade of the Pakistan Stock Exchange (PSX) from *Frontier* to *Emerging Market* status. The PSX crash on 16 June 2017 was possibly due to speculation in connection with this upgrade. The stock market is expected to recover, as the Pakistani economy continues to improve.

Corruption: According to Transparency International, Pakistan ranks 116 on the global corruption index, indicating widespread corruption. Last week a Pakistani anti-graft court issued an arrest warrant against Finance Minister Ishaq Dar, when he failed to appear before it in a corruption case related to the Panama Papers.

Corruption and opaque tender procedures remain a major issue for companies wanting to do business in Pakistan, though the situation is similar in other South Asian countries at varying degrees. India rates 79 on the index, Sri Lanka 95, Nepal 131 and Bangladesh 145.[10]

Ease of Doing Business: Last week the World Bank released its *Ease of Doing Business Index*, often used by foreign investors as a guide to a country. After improving its ranking in 2016 from # 148 to 144 (of 190 places), Pakistan slipped back to # 147 in 2017 (though still higher than Bangladesh at # 177).[11]

According to the index, Pakistan made it easier to 'start a business' and 'register property', introduced electronic processing of documents for exports and imports and strengthened port infrastructure. On the down-side was higher tax-rates and increased difficulty in getting credit for starting a business. Add to this an unreliable power supply and a cartelised industry.

Weak socio-economic indicators: While poverty has fallen by half since 2002, health and education remain heavily underfunded. According to The Economist, almost half of all those aged five to 16 are out of school, undermining prospects for economic growth, and thus Pakistan's long-term development depends on "better nutrition, health and education".[12]

[10] Transparency International: *Corruption Perceptions Index 2016*
[11] World Bank: *Ease of Doing Business Index 2018*
[12] The Economist, 19/1-2017: *Pakistan's misguided obsession with infrastructure*

The China-Pakistan Economic Corridor

The *China-Pakistan Economic Corridor* (CPEC) has been called "The Marshall Plan for Pakistan" and is considered a real game changer. Launched as part of the huge Chinese *One Belt One Road*-initiative, the CPEC is the biggest ever infrastructure project in Pakistan.[13] According to some estimates, if all the planned projects are implemented, the value of those projects will roughly be equivalent to all foreign direct investment in Pakistan since 1970. Pakistani officials predict that CPEC will result in the creation of around 2.3 million jobs between 2015–2030, and add 2 to 2.5 percentage points to the country's annual economic growth.

Originally President Xi Jinping promised USD 46 billion in grants and soft loans. This figure has now increased to USD 62 billion, half of which is earmarked power generation, the rest for roads, railways, dams, fiber-optic cables, cement factories, agroindustry, tourism, warehousing, pipelines, several Special Economic zones and a deep-water port at Gwadar, 600 kilometres west of Karachi.

China is expected to be the favoured partner in most CPEC-related projects. The Chinese government and the Chinese led Asian Infrastructure Investment Bank provides most of the financing. Yet, CPEC is not an exclusive Sino-Pakistani enterprise. Former Pakistani Prime Minister Nawaz Sharif has invited other countries on board, and several European countries see perspectives in CPEC. The United Kingdom, France, Switzerland are all negotiating with Pakistani and Chinese officials to start projects in connection to CPEC. Recently in Lahore, U.K. minister Boris Johnson called the CPEC *"a wonder project".*

"I am very excited about the CPEC idea. And I would like UK firms to participate in the construction of this fabulous venture".[14]

A pleasant surprise

Pakistan face major challenges: Infrastructural weakness, recurring power shortages, low competitiveness and a continuously heavy fiscal and trade deficit. Furthermore, a complex and confrontative political environment makes the future difficult to predict and economic reforms difficult to implement. The Swedish equivalent of EKF conclude in their country analysis, that – despite many improvements – the business environment in Pakistan won't improve in the near future.[15]

Others disagree. Earlier this year, economist Tyler Cowen – columnist at Bloomberg and cofounder of the blog *Marginal Revolution* – rated Pakistan the most overlooked economy of the world. He called Pakistan "a pleasant surprise".[16] Pakistan has a population of 200 million people and a booming and largely English speaking middleclass: half the Pakistani households now have their own washing machine. The economy is growing at 4-5% a year, security is improving and CPEC is providing the basis for great projects, higher growth rates and a long-term improvement of Pakistan competitiveness.

Whatever the perspective, it seems clear that Pakistan's general reputation is out of tune with reality. Companies willing to take a fresh view on Pakistan might find a land of new opportunity.

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[13] Bloomberg, 7/8-2016: *China's Marshall Plan*
[14] ValueWatch, 29/11-2016: *U.K., France, Russia Want to Join Pakistan-China's CPEC*
[15] EKN, 20/1-2017*: Landriskanalys Pakistan* provides a sober resume of the current situation in Pakistan
[16] Bloomberg, 6/2-2017: *Pakistan's Economy Is a Pleasant Surprise*