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## U.S. Funding Primes Market for Private Investment in Pakistan

*Investor Friendly Climate Generates Enhanced Opportunities for High Return Investments*

### Funding Initiative

On October 15, 2009, President Barack Obama signed into law the Enhanced Partnership with Pakistan Act of 2009, commonly referred to as the "Kerry-Lugar-Berman Bill" which authorized \$7.5 billion in nonmilitary aid to Pakistan over five years (\$1.5 billion for each of the fiscal years 2010 through 2014). The funding is intended to promote sustainable long-term development and infrastructure projects to support Pakistan's own efforts in building a stable, secure and prosperous Pakistan.

\$1.459 billion in aid for 2010 was appropriated on December 16, 2009. The available funding for 2010 will be disbursed by USAID/Pakistan through a competitive program of grants and cooperative agreements. Opportunities for these funding opportunities will be posted on USAID's website (<http://www.usaid.gov/locations/asia/countries/pakistan/>) and/or advertised in Pakistani newspapers. It is likely that certain contracts will be limited to business organizations resident in Pakistan. In addition to the formal grant process, certain funds may be made available in response to unsolicited proposals submitted in cooperation with established Pakistan non-governmental organizations. Funds will also be available for certain projects implemented by public-private partnerships.

Shortly after President Obama signed the Kerry-Lugar-Berman Bill into law, Secretary of State Hillary Clinton promised an additional \$125 million in nonmilitary aid to bolster Pakistan's energy infrastructure during her October 2009 diplomatic mission to Pakistan. In her recent speech to the Pakistan American Foundation, Secretary Clinton reiterated the U.S. administration's commitment to working with the Government of Pakistan to address the most immediate needs of the Pakistani people, particularly with respect to the energy shortages which are fueling insta-

bility and hindering economic development. Under the first of three anticipated phases, these funds will be used to upgrade key power stations and transmission lines in Pakistan in order to reduce the frequent incidents of power shortages and blackouts. The U.S. State Department has invited participants from the private sector in the U.S. and Pakistan to provide input and collaboration with respect to the use of these funds so that the most effective and efficient programs are implemented.

In addition to the aid promised by the U.S., the European Union and certain countries including Germany, China and Japan have committed to provide additional foreign aid to Pakistan and quasi-governmental lenders have stated commitments to support investment in Pakistan. The European Investment Bank ("EIB") and Asian Development Bank have committed to contribute a total of \$660 million to \$2.2 billion to a multi-year program to develop renewable energy projects in Pakistan. The Overseas Private Investment Corporation ("OPIC") is actively seeking opportunities to provide long-term financing and credit support for viable projects in Pakistan and is working to identify and support private sector lenders in financing projects in the country. OPIC also has been meeting with business leaders in key sectors of Pakistani industries to identify projects and discuss opportunities for OPIC's involvement.

This worldwide focus on Pakistan makes it an interesting time for U.S. and other foreign companies that are considering investing in or have projects planned in Pakistan and may enable such companies to reevaluate and more positively assess such projects. While there is always risk inherent in such investment, the halo effect that is created by the political environment and the involvement of governmental and quasi-governmental agencies may provide the additional stability necessary for compa-

nies to successfully launch a business opportunity in Pakistan.

### **Pakistan's Climate for Foreign Investment**

Strategically located at the crossroads of South Asia, Central Asia and West Asia with proximity to the Persian Gulf, Pakistan's democratically elected government is committed to becoming an investment destination for the international business community. Pakistan's growing middle class, amongst a population of 172 million, developed infrastructure, which currently includes a highway and rail system, multiple shipping ports and over 50 regional and/or international airports, provide key elements of the framework needed to attract investment. The Government of Pakistan has established and is committed to sustaining an investor-friendly policy, composed of favorable tax policies, support for and cooperation with foreign investors, guarantees with respect to the equal treatment of foreign and local investors and a commitment to provide physical security to foreign investors and their employees located in Pakistan. Additionally, the Government of Pakistan has established Special Economic Zones ("SEZs") and other industrial zones to give Pakistan a competitive regional advantage in attracting foreign investment.

U.S. companies have been actively engaged in Pakistan for decades, either directly or through franchise arrangements. Today there are many opportunities for companies that are interested in investment opportunities in Pakistan, including power, mining, exploration and exploitation of natural resources, agricultural, infrastructure and telecommunications. Following is a broad description of each of these sectors and the legal regime governing direct foreign investment in each area.

#### **Power**

Current estimates indicate that Pakistan suffers from an energy shortfall of 2,000 to 2,500 MW of power. The World Bank reports that this shortage is expected to increase to 6,000 MW by the end of 2010 and 30,700 MW by the year 2020.<sup>1</sup> There is a significant need for major investment in all areas of the power sector. In 1994, the Government of Pakistan passed legislation specific to the power sector to encourage a rapid expansion of privately owned and operated power projects. The laws have evolved over the last 15 years to address the early challenges that were encountered with some of the generation projects. Today the Government of Pakistan's relationship with these projects is strong, payments are being made in accordance with the power purchase agreements and many of the developers continue to see very strong returns on their initial investments.

#### **Independent Power Projects/Rental Power Projects**

To address the immediate power shortages, the Government of Pakistan issued a solicitation for: (1) processing of fast track IPP projects through International Competitive Bidding ("ICB") for the fast track implementation of multiple independent power projects, each of which must generate at least 100 MW, and some up to 1,000 MW, cumulative power generation under the jurisdiction of the Pakistan Electric Power Company ("PEPCO"); and (2) rental power projects, including barge-mounted plants, of up to 200 MW of cumulative generation capacity to be established throughout Pakistan.

#### **Renewable Energy - Wind, Solar and Small (less than 50MW) Hydel**

Pakistan has an abundance of renewable energy potential in the areas of hydro, solar, wind and biomass/biogas. Pakistan hopes to achieve a minimum of 9,700 MW generated by renewable energy technologies by 2030 by introducing

investment-friendly incentives to facilitate private sector investment in renewable energy projects. Under the 2006 Policy for Development of Renewable Energy for Power Generation (the "RE Policy"), the Government of Pakistan identified four strategic policy objectives: (i) energy security; (ii) economic benefits; (iii) social equity; and (iv) environmental protection. There are a number of fiscal incentives available to qualifying projects, including exemptions from various taxes, assurances with respect to repatriation and favorable regimes for raising equity locally.

#### **Hydel (Hydro) Power**

Pakistan has hydel potential of more than 40,000 MW, most of which lies in the North West Frontier Province ("NWFP"), Northern Areas, Azad Jammu and Kashmir ("AZK") and Punjab. Currently, only 15 percent of that potential power has been exploited. Hydel projects in the private sector will be implemented on Build-Own-Operate-Transfer ("BOOT") basis and must be transferred at the end of concession period to the Government of Pakistan.

#### **Power Projects in Thar Coal Reserves**

Pakistan has significant coal reserves which are estimated to be in excess of 185.5 billion tones. Approximately 175 billion tones of the lignite deposits are located in the Thar Coal Reserves, a 9,000 sq km area in the south-eastern part of Sindh that was discovered in the early 1990s. These reserves are reasonably close to the major population and load centers of Hyderabad and Karachi. Studies indicate that the proper exploitation of just half of these resources would be sufficient to generate over 100,000 MW annually for 30 years. The Government of Pakistan recognizes the substantial benefit of using coal to meet a significant portion of its energy demand and decrease its dependence on imported fuel. To encourage investment in this sector, the legislature has provided many

incentives for the use of coal for power generation under the Power Policy of 2002. In the near-term, the Government of Pakistan hopes that these incentives will lead to the establishment of 600 MW of power generated from coal resources with an increase to 3,500 MW over the long-term.

#### Mining and Natural Resource

As described above, Pakistan has significant coal reserves. Due to the high cost of imported energy, the Government of Pakistan has decided to enhance the share of coal in the overall energy mix from 5 percent to 19 percent by 2030. In addition to coal, Pakistan has significant metallic and non-metallic mineral resources. Currently there are approximately 52 minerals under exploitation. Pakistan's major mining production consists of coal, rock salt, and other industrial and construction materials. The value addition opportunities exist mainly for limestone, coal, gypsum, sulphur, crude oil and natural gas. The Government of Pakistan has established various incentives for qualifying mining projects, including an exemption from sales tax, import duties and other government levies during the exploration and construction stages. There is absolute protection from expropriation, and capital and profit repatriation is permitted. Mining operators will be allowed to insure their assets and risks with international insurance companies. Special investment policies exist for petroleum under the Petroleum Exploration and Production Policy of 2007 and for liquefied natural gas ("LNG") under the LNG Policy of 2006.

#### Agricultural

Agriculture is the largest sector of Pakistan's economy. This sector contributes 24 percent of GDP and employs close to half of the country's workforce. The Government of Pakistan has identified agriculture as an important area for continued development to address prob-

lems of unemployment and poverty and to foster economic development. New policies have been put in place to establish a network of testing laboratories for grains, livestock, fertilizers and agrochemicals. The key factor for continued development and expanded success in the agricultural sector is the availability of adequate water supplies for irrigation purposes which will require new investment in medium and large sized dams and improvements to the existing canal systems. There are additional investment opportunities in the development of infrastructure, machinery and technology for cattle farming and meat processing, development of dairy farms, technology for the fisheries, processing packaging and exporting fruits. The corporate agriculture farming ("CAF") package was introduced in October 2004. Under this package, public land can be purchased or leased for a term of 50 years through open auction, with the possibility to extend those leases for up to 49 years. Additional fiscal incentives may be available for certain qualifying projects including exemptions from sales tax for certain agricultural products and exemptions from customs duties and sales tax on certain equipment and machinery.

#### Infrastructure

The Government of Pakistan recognizes the need to enhance and expand its existing infrastructure system to sustain and encourage future economic development. In order to maximize this development and expansion, the Government of Pakistan intends to continue its strategy of privatization and seek additional foreign direct investment to supplement its own limited resources. Areas for targeted immediate development include roads and highways, bridges, railways, ports and terminals and airports. To encourage foreign investment in this sector, the Government of Pakistan has created favorable incentives for qualifying projects, including the contribution of up to 100 percent foreign equity, full remit-

tance of royalties, technical and franchise fees, capital, profits and dividends is permitted, reduced import duties for equipment, and reductions in the rate of income tax assessed on the project.

#### Telecom

In 2004, the Government of Pakistan liberalized the telecommunications sector and provided access to foreign investors. Foreign direct investment reached close to \$2 billion in 2006 and tele-density saw huge increases, particularly in the area of cellular mobile phones. The Government of Pakistan is committed to actively supporting and providing an enabling environment for continued growth and development of the telecom sector. All telecom services have been deregulated and the processing period for license applications has been reduced. There are numerous opportunities for investment in this rapidly growing sector and favorable investment policies, tax and other fiscal incentives are available to foreign investors.

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#### Endnotes

- 1 "Potential and Prospects for Regional and Energy Trade in the South Asia Region," *The World Bank*, 2007.

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## U.S. Funding Primes Market for Private Investment in Pakistan (cont'd.)

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