The Pakistan Business Council
FOSTERING ECONOMIC GROWTH
(A Company set up under Section 42 of the Companies Ordinance 1984)

Comments on the Saudi Investment Law and Recommendations on Promoting Efficiency-Seeking Investment in Pakistan

A country's investment regime is composed of the following key elements, of which the investment law is one:

- Clarity of investment priorities within the context of its comparative advantage;
- The structure, processes, and incentives (including taxes) to make it easier and cheaper to do business;
- The quality and speed of dispute resolution;
- Effectiveness of protection of intellectual property rights;
- Timely remittance of dividends and sale proceeds; and
- Investment law that guarantees the security of investment.

The Kingdom of Saudi Arabia recently promulgated a new Investment Law, which provides the basic legal framework to promote local and foreign investment in line with the Kingdom's Vision 2030. The law is modeled on best practices in countries with investment-friendly environments – Singapore, UAE, Indonesia, Germany, Turkiye, and the United States. It moves the Kingdom from the hitherto controlled investment regime favoring local sponsors and investors to one that prescribes parity between foreign and local investors. Additional comfort is provided through provisions governing alternative dispute resolution, securing intellectual property rights, and timely remittance of profits and capital repatriation. It broadens the definition of investment beyond capital contribution to include contractual rights, rights under licenses, technical agreements, and intellectual property. The law also ensures that neither local nor foreign investments can be expropriated without fair compensation.

Pakistan's Foreign Private Investment (Promotion & Protection) Act of 1976 (1976 Act) and the Economic Reforms Act of 1992 (1992 Act) together cover most of the provisions of the Saudi law, except for alternative dispute resolution and recognition of non-capital investments. A separate law in Pakistan covers protection of Intellectual Property Rights but is not implemented effectively. While the 1976 Act covered foreign investment only, the 1992 Act broadly applied similar provisions to local investment.

Pakistan's Foreign Investment (Protection and Promotion Act 2022 (2022 Act), drafted with large (over $500Mn investments such as Reko Diq) in mind, goes several steps beyond the earlier Acts (and the Saudi Law) in providing relief from all taxes, including immunity on the source of funding, customs duties, and labour laws, including Workers Welfare Fund contributions. It also provides for the 2022 Act to prevail even when there is a conflict with other laws. A positive step is the establishment of an Investment Ombudsman. Drafted with a significant foreign investment in mind, the provisions of the 2022 Act do not apply to local investments of over $500 Mn, thus creating a disparity in treatment.

While investment law is essential to provide a legal framework, without a favorable security and investment climate, meaningful and desirable investment will not materialize. The law in Pakistan has, for some time, provided a legal framework comparable to the one now proposed by Saudi Arabia. The Pakistan Business Council, in its study on efficiency-seeking FDI (Click to download), recommended the following:

Despite high returns (49-110% for companies like Nestle and Unilever), Pakistan's FDI performance has been weak, with an overemphasis on market-seeking FDI and repatriation issues. The strategy overlooks critical sectors like export-driven industries, advanced manufacturing, value-added agriculture, electronics, and IT, prioritizing commodities and resource extraction instead. To achieve long-term growth, Pakistan must:

- Modernize infrastructure, particularly in logistics, transportation, and energy, to support export industries.
- Streamline regulations by reducing bureaucracy, simplifying tax structures, and embracing digitalization.
- Strengthen domestic manufacturing and focus on value-added exports.
- Negotiate stronger trade agreements for better market access. Optimizing its investment policy and focusing on efficiency-seeking FDI is essential to revitalize inflows and drive sustainable economic growth. Key focus areas are summarized below:

1. Shift Focus to Efficiency-Seeking FDI: Pakistan should transition its FDI strategy to efficiency-seeking FDI, focusing on export-driven industries. This would reduce reliance on domestic consumption and foster export-led growth, helping improve the trade balance and foreign exchange reserves. This is also necessary to minimize capital outflows via profit repatriation and encourage reinvestment of profits within the country. At the same time, MNCs need to optimize the existing and prospective market-seeking FDI by using their scale, global networks, and country's strategic position for exports, and the government must assist by offering fiscal incentives and improved infrastructure to make the overall investment climate conducive.

2. Enhance Labor Market Competitiveness: Pakistan should invest in labor market reforms by improving skills, labor productivity, and workforce training programs tailored to industries that can attract high-value FDI, especially in the manufacturing and technology sectors. The country needs to incentivize digital skills, and investment in technology and R&D to shift the labor market from low-productivity sectors to more innovation-driven industries. MNCs can lead this labor development initiative as part of their "give-back" to the country from which they reap a demographic dividend. Generally, MNCs can play their role in promoting innovation in the local economy by partnering with local businesses, as they have access to the latest technologies and business practices. In practice, however, most MNCs in Pakistan, with a few exceptions, have limited R&D capabilities and primarily operate imported machinery; While they do train their own workforce, they might not have the incentive to extend such training programs to the public.

3. Diversify FDI Sources and Sectors: The country must diversify its FDI sources beyond China and traditional sectors like power and telecom, as well as encourage investments from other countries, particularly in IT, agriculture, textiles, and light manufacturing. Offering sector-specific incentives and improving the regulatory framework could achieve this. Convincing Western countries that once were the dominant investors to use Pakistan as a base to manufacture goods for export to China, leveraging Pakistan's FTA with China, could be an attractive proposition if approached strategically with potential benefits for both export expansion and market penetration. The key lies in making use of the tariff lines under CPFTA, which could include components of mass-produced articles, components of light electronics, manufacturing auto parts and machinery components, and processed food and agricultural products.

4. Incentives for Export-Oriented Sectors: The investment climate could significantly benefit from more targeted, time-bound incentives that are better aligned with the needs of different sectors, particularly those that drive exports and technological advancement.

Policies should encourage FDI that not only serves the local market but also boosts exports, such as the readymade garment sector in Bangladesh and electronics in Vietnam. Given limited resources, the government does not have the fiscal space to spend on legacy industries. In that case, all efforts should be directed at incentivizing new technology in an existing industry or high-tech industry.

5. Strengthen Regulatory and Policy Framework: It is imperative to improve the business environment by addressing policy uncertainty, bureaucratic hurdles, and corruption. Regulatory reforms can achieve this by ensuring long-term stability and predictability for foreign investors. Digitalizing Pakistan's regulatory environment is crucial for improving efficiency and transparency. One approach could be to encourage third-party vendors to provide front-end services and oversee regulatory functions. This would streamline processes, reduce bureaucratic delays, and enhance accountability through digital tools, ultimately creating a more efficient and transparent system for businesses and investors.

6. Improving Intellectual Property Rights: Strong IPR laws are necessary to provide assurance to foreign investors that their innovations, brands, and proprietary technologies will be protected, making Pakistan a more attractive destination for investment. Companies in sectors like pharmaceuticals and technology are more likely to invest in countries with robust IPR protections to safeguard patents, copyrights, and trademarks. Protecting intellectual property can also incentivize local innovation, technology transfer and investment in R&D. Moreover, by protecting products like software, pharmaceuticals, and branded goods, Pakistan can increase exports of higher-value products, moving beyond raw materials and low-tech goods.

7. Leverage Special Economic Zones (SEZs) for Export-Oriented Growth: The SEZs have been a source of concern due to the delays and inefficiencies in their establishment and operations. Notwithstanding the agreement with the IMF to discontinue fiscal incentives, the SEZs can still provide affordable land, utilities, proximity to road networks and opportunity to sectoral clusters. The government must also leverage SEZs to enhance the indigenization of inputs for import substitution. Indigenization can foster forward and backward linkages to support various sectors, such as building a local oilseed and tallow sector or decreasing imports of textile auxiliary materials like buttons, zippers, and so on. Other sectors include automotive, IT, and pharmaceuticals.

Improving SEZs under the China-Pakistan Economic Corridor (CPEC) could also play a role in attracting Chinese investments and relocating industries to Pakistan. However, in that case, the government must provide additional security. SEZs, especially those linked to CPEC, are located in regions with security challenges, such as Balochistan. Moreover, Industries relocating from China will bring foreign employees, equipment, and sensitive infrastructure. Securing these assets is critical to maintaining smooth operations and avoiding disruptions or attacks that could harm Pakistan's investment reputation.

8. Foster Public-Private Partnerships & Joint Ventures: The investment climate should encourage JVs and PPPs, particularly in the infrastructure, technology, and agriculture sectors, to attract FDI while reducing the fiscal burden on the government because they allow for shared risks and capital. Saudi Arabia and China are regions with significant investment potential. Pakistan should focus on securing JVs in these regions, balancing capital inflows with long-term economic growth and national interests.

9. Investment Liberalization and Policy Consistency: Pakistan should open the economy to foreign investors through liberalized policies, trade openness, and a favorable business environment, while also ensuring that foreign investors do not receive more

favorable terms than local investors. By maintaining consistency in agreements with foreign investors and honoring contractual obligations, the government should prioritize creating a stable policy environment. To improve the investment climate, governments should focus on macroeconomic and political stability, as well as structural and institutional improvements that benefit domestic enterprises rather than only foreign investors.

10. Alignment of FDI with Trade and Industrial Policy: FDI policies often act in isolation from trade and industrial policies, leading to limited innovation and weak spillovers to the domestic economy. First, there is no industrial policy. And while Pakistan has a recently updated investment policy, there is a need for sector-specific investment policies that focus on sectors in which Pakistan has a comparative advantage. To maximize domestic benefits, it is crucial to align FDI policies with trade and industrial strategies. The focus should be on technological upgradation in sectors with high-value exports and industrial upgrades, such as advanced manufacturing and digital industries.

11. FDI Promotion and Marketing: Instead of organizing "grand" roadshows that often gather second- and third-tier investors without resulting in meaningful investments, the government should consider alternative strategies like targeted meetings, industry conferences, virtual investor meetings, webinars, JVs, and investment syndicates, and leveraging on the success of existing investors.

12. Long-term Loans: The government must encourage the facilitation of local and foreign currency loans to enhance capital access, project financing, risk management, and reduce exchange rate risk. The government should introduce policies that support long-term lending, such as tax incentives for banks offering long-term loans or guarantees for large projects. It should facilitate the development of regulatory frameworks for easier access to long-term financing for foreign investors. The Reserve Bank of India (RBI) has various schemes to promote external commercial borrowings (ECBs) in foreign currencies, allowing firms to access international capital markets. The State Bank of Vietnam supports long-term foreign currency loans, particularly in key economic zones and for large infrastructure projects.

13. Reforming the Tax Regime: The country's tax regime burdens the formal sector and widens the arbitrage with the informal sector, which discourages investment. The government should gradually reduce corporate income tax for the formal efficiencyseeking industries, such as the manufacturing and high-tech sectors, to attract both foreign and domestic investors. The goal should be to position Pakistan as a tax-competitive destination for both local and foreign investors by relaxing taxation regimes to ensure a level playing field.

14. Targeted FDI and Industrial Policies: To boost investment in key sectors like agriculture, tourism, textiles, manufacturing, and IT, authorities must devise tailored strategies and offer targeted incentives such as tax holidays, duty exemptions on the import of machinery, equipment, and raw material, and special zones to drive growth and modernization for both local and foreign investors. In addition to tax holidays for value-added processing in agribusiness, textiles not presently made or exported, electronics, consumer goods, home appliances, and IT, the following table highlights sector-specific policies:

Targeted FDI and Industrial Policies	
Sector	Key Policies
Agriculture	- Long-term land leasing for investors - Joint R&D centers for crop development and irrigation - Investments in smart agriculture technologies (IoT, AI) - Cold chain infrastructure development
Tourism	- Special tourism zones with relaxed regulations - PPPs for tourism infrastructure - Global marketing campaigns - Simplified visa procedures, e-visas, and visa-on-arrival
Value-Added Textile	- SEZs for textile sector - Partnerships with local firms and global brands - R&D partnerships for sustainable textiles and modern machinery subsidies
Light Manufacturing	- Incentives like Tariff Differential Subsidies for automated manufacturing systems (3D printing, robotics) - Skill development centers - Attracting FDI for automotive component production and EV manufacturing plants
IT Services Sector	- Corporate tax exemptions for technology parks and IT training centers - Concessional loans for IT facilities - Special Technology Zones (STZs) - Streamlined export documentation for IT services - Partnerships for R&D and training in fintech, HealthTech, and EdTech