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and Sustainable Development

# Opportunities and Risks of Liberalizing Trade in Services in Pakistan

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**ICTSD Draft for Comments Only**

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## ACRONYMS

| | |
|---|---|
| APCA | All Pakistan Contractors Association |
| CBR | Central Board of Revenue |
| CPC | Central Product Classification |
| CY | Calendar Year |
| DHA | Defence Housing Authority |
| DISCOs | Power Distribution Companies |
| EC | European Communities |
| ENTs | Economic Needs Testing |
| FBS | Federal Bureau of Statistics |
| FDI | Foreign Direct Investment |
| FESCO | Faisalabad Electric Supply Company |
| FPCCI | Federation of Pakistan Chambers of Commerce and Industry |
| FY | Fiscal Year |
| GATS | General Agreement on Trade in Services |
| GDP | Gross Domestic Product |
| GENCOs | Power Generating Companies |
| GoP | Government of Pakistan |
| ICRIER | Indian Council for Research on International Economic Relations |
| IIFT | Indian Institute of Foreign Trade |
| IMF | International Monetary Fund |
| IPP | Independent Power Project |
| IT | Information Technology |
| KESC | Karachi Electric Supply Corporation |
| LCCI | Lahore Chamber of Commerce and Industry |
| MA | Market Access |
| MFN | Most-favoured Nation |
| MoC | Ministry of Commerce |
| MW | Megawatts |
| NBFIs | Non-bank Financial Institutions |
| NCAER | National Council of Applied Economic Research |
| NCBs | Nationalized Commercial Banks |
| NEQS | National Environment Quality Standards |
| NT | National Treatment |

| | |
|---|---|
| OGDC | Oil and Gas Development Company Limited |
| Pak-EPA | Pakistan Environmental Protection Agency |
| PCATP | Pakistan Council of Architects and Town Planners |
| PEC | Pakistan Engineering Council |
| PPIB | Private Power and Infrastructure Board |
| PPL | Pakistan Petroleum Limited |
| PSO | Pakistan State Oil Company |
| PTCL | Pakistan Telecommunication Company Limited |
| R&D | Research and Development |
| SBP | State Bank of Pakistan |
| SECP | Securities and Exchange Commission of Pakistan |
| SMEs | Small and Medium Enterprises |
| SOEs | State-owned Enterprises |
| TMAs | Town/Tehsil Municipal Administration |
| UNCTAD | United Nations Conference on Trade and Development |
| WAPDA | Water and Power Development Authority |
| WTO | World Trade Organization |

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# EXECUTIVE SUMMARY

## Overview

The services sector is becoming an increasingly important dimension of Pakistan's economy due to its major contribution to growth in GDP and due to its export potential in the coming years. While multilateral liberalization of services trade achieved under the Uruguay Round has been limited, the success or failure of negotiations in the Doha Round of multilateral negotiations would largely determine the future of services trade liberalization in the country.

Pakistan has received several requests from its trading partners in the Doha Round negotiations for improved market access and national treatment of service providers. Among others these requests relate to construction and related engineering services; architectural, engineering, and integrated engineering services; energy services; and environment services. Likewise, Pakistan has also tabled requests on improved conditions for temporary movement of natural persons for purposes of supplying services and cross-border supply of services, among others.

This study seeks to examine how locking-in of our unilateral liberalization at the WTO and further liberalization of services trade would affect Pakistan's competitiveness. Moreover, the study also focuses on the opportunities and risks of such liberalization and discusses possible options regarding the corollary regulatory reforms and other flanking measures that may be needed to achieve these goals. The sectors studied are (a) construction and related engineering services; (b) architecture, engineering and integrated engineering services; (c) energy services; and (d) environmental services.

## Contribution of Services Sector to Pakistan's Economy

Because Pakistan does not collect data under four modes of supply of the GATS, it makes very difficult for one to clearly portray Pakistan's position in services trade. Part of the problem is that the classification system used to collect data on services trade is obsolete, which urgently needs to be changed. The importance of services sector to Pakistan's economy has substantially increased over the last three and a half decades whereby the share of services in GDP has gone up from 45 per cent in 1969-70 to almost 58 per cent in FY 2005-06. Services sector's contribution to GDP growth has gone up to 68.3 per cent in FY 2005-06 while the rest of the share goes to the commodity producing sectors.

Due to deficiencies in services statistics, measuring services exports and imports is extremely difficult due in part to

i) rapidly changing boundaries between services and industry, and
ii) out-dated, ambiguous and outdated services classifications.

Nevertheless, the available statistics indicate that despite Pakistan being a small global service provider, its imports are growing faster than its exports. Therefore, Pakistan needs to explore ways by which comparative advantage in services could be tapped.

Even though share of services sector in the GDP has increased overtime but services share in employment has not increased in this period, which reflects poorly on the poverty alleviation potential of services sector growth. This may be explained by the fact that growth has mostly occurred in knowledge-based sub-sectors.

## Consultative Mechanism on Services Trade

Pakistan still needs to set up institutional foundations that could help them formulate effective trade negotiating strategies on bilateral and multilateral fronts to maximize gains and to minimize risks of exploitation by their negotiating partners. Our findings suggest that presence of a formal "bottoms-up" rather than "tops-down" consultative mechanism involving all national stakeholders on multilateral services trade issues is direly needed.

While an elaborate consultative mechanism has been set up to formulate annual trade policy involving private sector and civil society actors, the consultative mechanism for negotiating bilateral and multilateral agreements on trade in services is more inward looking. In effect, most national stakeholders are left out of the loop, except for the state actors, on services trade negotiations at the WTO. Our evidence shows that informal consultations are often made with elite representatives of peak national organizations on an ad hoc basis, or as and when such an input is needed by the government. But, the government has yet to define a formal consultative mechanism, like the one present for annual trade policy, for bilateral and multilateral services trade negotiations where non-state actors such as private sector, academia and civil society are also involved. In the absence of such a mechanism the government officials are holding the major responsibility of taking positions on services trade issues.

Absence of thorough sub-sector specific assessments of Pakistan's services trade remains a major constraint in developing foresight and in effectively participating in trade negotiations at the WTO. Government machinery is under resourced to cope with the full range of trade issues and so are the professional associations. They need to enhance in-house capacity to conduct and evaluate sub-sector assessments so that they could provide timely support to the Geneva based negotiators.

Due to inadequate capacity, both the public and the private sectors are not cut out to evaluate implications of the proposals being negotiated at the multilateral level. The problem is further compounded by feeble services trade statistics available in the country. Involvement of civil society organizations and academia has the potential to fill the void created by weak institutional capacity of public and private organizations, but they would also need a sound data base on trade in services before they are of much help.

## Stakeholders' View on Pakistan's Request/Offer

A general advice coming from the stakeholders was that Pakistan should lock-in each sub-sector in which it has a stated policy. Moreover, the stakeholders also advised that Pakistan should widen the coverage of liberalization and not to deepen the extent of it in each sub-sector. In general, the public sector involved in provision of selected services was the proponent of a more conservative policy toward further liberalization for obvious reasons. However, the exception to this locking-in view was the private stakeholders in the environment service sector, especially those in waste management services and services related to environment, who were fairly optimistic about the prospects of further liberalization for the simple reason that the size of the domestic market was large and local players were unable to meet the increasing demand.

Another general message coming out of interviews with stakeholders was the consensus on the conditions on which further liberalization should be allowed by Pakistan. Specifically, it was observed that further liberalization should focus on joint ventures with local firms by maintaining domestic equity requirements while the government should ensure that these collaborations do end-up facilitating technology transfer to local partners. Greater liberalization was also sought for services trade in the regional perspective due to its greater potential for transfer of appropriate indigenous technology and know-how, especially with India.

Lack of involvement in policy formulation and decision-making process was an overriding concern of the majority of private and even some public sector stakeholders. Moreover, ambiguity and concerns regarding various government policies was also a great concern for the stakeholders.

## Negotiating Strategies for Pakistan

Most stakeholders in Pakistan's selected services sectors are constrained by limited capacity and resources to evaluate and share their meaningful insights on highly tricky issues that are being debated by Pakistan in their multilateral negotiations in the GATS. Absence of technical sector-specific studies on the likely implications of the new liberalization measures makes it even more difficult both for the public and the private sectors to evaluate the market impacts of these proposals. Despite these constraints Pakistan's negotiating team in Geneva would like to know what negotiating strategies they should follow so that the gains are maximized and adjustment costs are minimized when these proposals are implemented.

Unilateral liberalization of the services sector has been the hallmark of Pakistan's policy. Significant progress has already been made toward liberalization of key infrastructural or backbone sectors. These reforms provide a window of opportunity to Pakistan to gain concessions from its negotiating partners by locking-in at its current level of commitments in multilateral negotiations. Pakistan must devise some broad principles to formulate its strategy for informal positioning in multilateral negotiations. Among others, these principles should focus on:

i) Medium-term development objectives
ii) Potential for technology transfer
iii) Potential for enhanced efficiency and service quality
iv) Potential for employment generation
v) Presence of appropriate regulatory framework

*Construction and related engineering services*

Construction sector is a potential import as well as export interest to Pakistan, which represents a fundamental activity with strong forward and backward linkages. Growth in this sector is critical for growth in national income and employment in the country. Hence its mainstreaming would help achieve national development goals.

Majority of constructors are small players who have weak financial positions, out-dated labour-intensive technology and poor organizational structures and vision for growth and development. They are highly vulnerable to foreign competition. Most constructors have comparative advantage in small commercial buildings, small bridges and roads. Only a few sophisticated firms specialize in large earth work and large construction work for civil engineering. While modernization of this sector with entry of foreign firms may enhance efficiency and service quality in this sector, but the likely injury to small players would be a major challenge for the negotiators.

Some large sophisticated firms are also present in the construction sector that compete internationally due to specialization and cost effectiveness, especially in the Middle East. The comparative advantage of these firms mostly lies in cheap skilled and un-skilled labour, and experienced engineers who have previously worked for multinational companies in Pakistan or abroad. Two most significant factors that are linked with the success of these companies are a) acceptability of engineering qualifications of engineers educated in Pakistan and b) unrestrained flow of temporary movement of natural persons. If Pakistan is to gain from the on-going negotiations in the Doha Round, its stand in the construction sector should be built around these factors.

Pakistan's initial offer signals liberalization commitment in market access in construction work for bridges, elevated highways, tunnels and subways (CPC 5132 + CPC 5132) subject to equity/joint venture limit of 60%, in addition to removing restrictions on Mode 1 and Mode 2 commitments. These commitments do not significantly differ from the actual policy on ground. Therefore, Pakistan may conveniently want to lock-in at this level.

Pakistan has maintained market access restrictions on Mode 3 in CPC 511 to CPC 518. These restrictions have been designed to protect small players from foreign competition and to avoid displacement of domestic construction workers since foreign players would have comparative advantage in using more mechanized constructions with highly skilled work-force. Shielding all local players (both small and large) from foreign competition by giving them a blanket cover may not be justified. While it may be feasible to restrict commercial presence in smaller building plans to shield small constructors, market access restrictions on larger building plans may have little justification, if any. Market access limitations are also maintained in the initial offer on renting services on equipment for construction or demolition of buildings (CPC 518), which is not in-line with the position of the industry players who see in this an opportunity. Pakistan may want to revise its offer because commercial presence of foreign players is likely to benefit the industry by relieving them from making major capital investments.

MA limitations on foreign equity remain, yet equity limit has been raised from 51% to 60%, which restrict FDI to joint venture. Transfer of technology appears to be the motivation behind this limitation. If seen from policy on ground, Pakistan appears to have kept some cushion in foreign equity requirement that it may want to use in its revised offer. The extent and pace of liberalization in the construction sector would largely depend on its current preparedness and the speed with which regulatory reforms could be introduced. Therefore, the timing of liberalization has to be appropriately sequenced to maximize the benefits and to minimize its adjustment costs to the national stakeholders.

Finally, the negotiators should bear in mind that the Members have not included in their request for the construction sector the temporary movement of natural persons (Mode 4). Since Pakistan's comparative advantage lies in cheap labour and its pool of experienced professionals, Pakistan may not be able to effectively compete on foreign turf in the absence of Mode 4 clause while service providers from requesting Members are likely to gain from this clause.

*Architectural, Engineering and Integrated Engineering Services*

In architectural, engineering and integrated engineering services, Pakistan has made new commitments in its initial offer in Mode 2 and Mode 3 and has raised equity limit from 40% to 51% subject to participation of local players for architectural services (CPC 8671), engineering services (CPC 8672) and integrated engineering services (CPC 8673).

Since architectural and engineering designs can be conveniently supplied through trans-border data flows (Mode 1), countries having relative comparative advantage are likely to benefit from liberalization commitments under Mode 1. Pakistan has a pool of cheap experienced professional engineers and architects, which is a source of comparative advantage to Pakistan. Therefore, liberalization commitments under Mode 1 would be in Pakistan's export interest. Pakistan may also want to further rationalize its commitments under Mode 3 to enhance benefits from Mode 1, because arguably Pakistan may be able to export more through Mode 1 by attracting more foreign firms or joint ventures in architectural, engineering and related engineering services.

*Energy Services*

This is an area of import interest to Pakistan where there is the opportunity to lock-in the reforms already introduced after the Uruguay Round.

Pakistan has not made any commitments on management consulting services and related services (CPC 865 + 866). Similarly, related technical consulting services (CPC 8675 partial), and maintenance of prefab metal products, machinery (CPC 8861 – CPC 8866) are other related services in which no commitments have been made. There is scope for Pakistan to consider liberalization on construction work in some sub-sectors in which local capacity is not present.

In general, it is difficult to comment on the feasibility of liberalization on management consulting and related consulting services due to absence of sector-specific studies to assess their market impacts. Appropriate regulatory framework is also not present to warrant their liberalization. Therefore, the negotiators are advised caution in deepening the extent of liberalization in these specific sub-sectors.

*Environmental Services*

Pakistan has substantial import interest in this sector through Mode 3. Waste collection and its recycling have a lot of scope for commercial presence of foreign firms through Mode 3. But Pakistan's initial offer in refuse disposal (CPC 9402) and sanitation and similar services (CPC 9403) does not cover public works functions owned by the government, local governments or those functions that are contracted out by them. Since most refuse disposal and sanitation services are under the control of city district governments (local governments), this condition practically rules out presence of foreign investment. Therefore, further liberalization would be in Pakistan's interest.

Similarly, Pakistan has no policy on cleaning services for exhaust gases (CPC 9404), noise-abatement services (CPC 9405), nature and landscape protection (CPC 9406) and other environmental services (CPC 9409). The existing evidence shows that collaboration with foreign environmental consultants is producing healthy results and is also leading to technology transfer. Due to dearth of qualified engineers and excess demand in the local market, further liberalization commitments through Mode 1 and Mode 3 would be beneficial in terms of service quality, technology transfer and cleaner environment.

*Temporary Movement of Natural Persons*

Temporary movement of natural persons under Mode 4 is least liberal areas of the GATS, but potentially an area of most interest to Pakistan. Existing commitments are mostly horizontal and linked with commercial presence, which attach quite tough conditions on sectors of particular interest to Pakistan. Pakistan seeks commitment of common categories, which are de-linked from commercial presence.

While Pakistan's remittances at present are recorded at around US$ 4 to 5 billion per annum, this flow has never remained stable. Due to availability of huge pool of trained and semi-trained workers, Pakistan could expect most benefit from such flows. Success in removal of Mode 4 restrictions on movement of natural persons has developmental and poverty alleviation angels. The negotiators may want to use this window of opportunity by taking informed position while bargaining with its negotiating partners.

# 1. INTRODUCTION

With continuing liberalization, trade in services has been growing rapidly in the world economy. Currently, services account for more than two-thirds of total foreign direct investment (FDI) inflows [UNCTAD (2006)]. Traditional trade liberalization of goods by many developing countries in the 1990s has not fully delivered the promised fruits in the form of prosperity [Rodrik (2001)]. However, the evidence shows that when domestic service sectors are insulated, simply lowering of tariffs on goods trade promises only modest gains in aggregate welfare [Konan and Maskus (2006)]. Services are the largest productive sector in any economy and many services are crucial inputs into products that compete in domestic and international markets. Indeed access to efficient (low cost) and productive input services are an important determinant of economic productivity and competitiveness in the entire economy. Thus, liberalization of services is not just for expanding export in services trade, but also to facilitate domestic producers gain competitive advantage with access to more efficient (low cost and high quality) and diversified producer services available in world markets.

The role of services sector is crucial in sustaining the growth of Pakistan's economy, with a share (including construction, electricity and gas distribution) in GDP of 57.5 per cent and a share in employment of 36 per cent in FY2006. The services sector has been a major contributor to the overall growth in GDP with its remarkable real growth averaging 7 per cent over the past four years while major growth at the rate of 8 per cent or more occurring only in the last two years [GoP (2006)]. Thus, services are assuming the role of a new growth powerhouse in the country by contributing 68 per cent to GDP growth in FY2006 [GoP (2006)].

Pakistan is pursuing liberalization of trade in services through unilateral liberalization, reciprocal negotiations, regional integration agreements, and bilateral free trade agreements. But, the most far reaching economy-wide impact is linked with multilateral liberalization of services under the World Trade Organization (WTO). While multilateral liberalization of services achieved under the Uruguay Round has been quite limited, the future services trade liberalization would largely depend on the success or failure of negotiations between the Member countries under the existing Doha Round of talks.

In the Doha Round of negotiations, Pakistan has received requests from its trading partners for improved market access (MA) and national treatment (NT) of foreign service suppliers either bilaterally or plurilaterally. Pakistan has received a number of these requests, including in construction and related engineering services; architecture, engineering and integrated engineering services; energy services; and environmental services. On the other hand, Pakistan has also tabled requests on improved conditions for the temporary entry of its natural persons for purposes of supplying services (Mode 4) and cross-border supply of services (Modes 1 and 2), among others. At the least, the negotiations provide an indication of the specific sectors where there is substantial interest in FDI or supply, and where trade and regulatory regimes are sought to be improved and locked-in.

In the wake of these developments, the opportunities as well as risks of liberalizing trade in selected service sectors largely depend on the relative comparative advantage in respective sectors. Hence, a major challenge faced by countries like Pakistan is to design a rational policy consistent with domestic policy objectives. Because failure to do so is bound to adversely affect the growth of service industries.

How liberalization of services affects economic productivity and competitiveness in Pakistan's economy although has largely remained unexplored, yet it has a wider appeal. In a recent study, Saeed et al. (2005) present information on services trade by modes of supply, operational constraints and export capacity in five service sectors of Pakistan including IT; financial services; construction and architectural services; professional services; and medical and health services. They note important forward and backward linkages between the services sector and the major commodity producing sectors, and argue on the basis of interviews with the firms that there is significant on-going trade in services and scope in the export markets in all modes of supply in the selected sectors. However, they do not state the potential impact of liberalizing trade in services in the post-Doha environment. In this regard, based on 'informed judgment', Mahmood (n.d.) has proposed that Pakistan should move away from its traditional policy focus on inward investment to export promotion, for example, by seeking outlets for foreign investment, and by extending its interest to cross-border trade in services. In an ideal world, one may want to employ empirical investigation to make judgment on the consequences of services trade liberalization, but non-availability of data on services trade by modes of supply remains a major impediment toward this end.

This study seeks to provide a snapshot of services trade in Pakistan with a specific focus on sectors and sub-sectors deemed critical to Pakistan's trade and sustainable development. More specifically, the study seeks to examine how locking-in of unilateral liberalization at the WTO and further liberalization of services would affect Pakistan's competitiveness. Moreover, the study also focuses on the opportunities and risks associated with liberalising trade in selected services sectors or modes of supply and possible options regarding the corollary regulatory reform and other flanking measures that may be needed to achieve these goals. The sectors to be studied are: 1) construction and related engineering services; 2) architecture, engineering and integrated engineering services; 3) energy services; and 4) environmental services.

The study is organized as follows. In Section 2, we describe four modes of supply developed as part of the General Agreement on Trade in Services (GATS) framework, while in Section 3 we discuss the role of services sector in Pakistan's economy. Section 4 outlines the role of the state in the services sector of Pakistan and Section 5 provides a description of Pakistan's existing Uruguay Round commitments in the selected service sectors. Section 6 pertains to Pakistan's request/offer process in the Doha Round of talks while Section 7 evaluates the involvement of national stakeholders in negotiating process. Section 8 is about stakeholders' feedback on Pakistan's request/offer process. Finally, Section 9 concludes the study with discussion on negotiation strategies for Pakistan in the Doha round.

## 2. MODES OF SUPPLY

The adoption of the GATS in the Uruguay Round of talks has extended the multilateral rules and disciplines to services trade. The founders of the GATS recognized the importance of various channels through which international delivery of services takes place. Therefore, at the time of developing the GATS, four modes of supply were also developed as part of the GATS framework agreement so that member countries could organize and schedule their MA and NT commitments and obligations. These modes are: a) cross-border supply (Mode 1) for non-resident service suppliers (e.g., transportation services, trans-border data flows); b) consumption abroad (Mode 2) as with a consumer travelling to another country (e.g., tourism); c) commercial presence (Mode 3) (e.g., presence of one member in another member's territory for provision of services through FDI or representative offices and branches); and d) movement of natural persons (Mode 4) (e.g., entry and temporary stay of foreign personnel providing those services).

Most-favoured nation (MFN) is a basic obligation of all WTO members seeking non-discrimination by trading partners requiring them to apply commitments equally to services and service providers from all other member countries. Exemptions to MFN can be made under the GATS, but they are subject to negotiations. Market access and national treatment are obligations that are specific to the GATS. These commitments only apply to services that are specifically listed by member countries in their schedule of commitments.

While liberalization in the services sector is associated with country commitments in all modes of supply, the members are under no obligation to make commitments in all of the modes in respective sectors. They have complete freedom to choose sectors and modes in which they want to make commitments. The members are free to make commitments in all the four modes in a particular sector, or selectively choose among them based on the readiness of their respective sectors.

# 3. THE ROLE OF SERVICES SECTOR IN PAKISTAN'S ECONOMY

## 3.1 Introduction

Developments in the field of information technology (IT) since 1990 have expanded the range of services that can be traded internationally. Many of the services that were considered non-tradable until mid-1990s are now actively being traded. The growing interdependence between markets and production activities across countries is fundamentally explained by growth in service industries led by this IT revolution [Primo Braga (1996)].

While services comprise of a wide range of economic activities, a characteristic feature of recent thrust of services is the rapid expansion of knowledge-based industries, e.g., business services, finance and insurance services, information and communication technology, modern healthcare and education services, and environmental services, etc. Growing cross-border supply of these services is explained by marked reduction in communication costs associated with advances in IT. At another level, these developments have rapidly altered the traditional boundaries between services and industry whereby a large part of the services are now sold while embedded in the form of goods. Here we provide a brief sketch outlining the contribution of the services sector to GDP, services traded internationally, and share of services in employment generation.

## 3.2 Contribution of Services Sector to GDP

In should be stressed that Pakistan does not collect data under four modes of supply of the GATS, which makes it difficult to assess Pakistan's position in trade in services. Like other developing countries, the statistics on services sector of Pakistan have many deficiencies. Some of these deficiencies relate to obsolete classification systems in vogue while others has to do with the level of dis-aggregation with which the collected data on the services sector of Pakistan is reported. The Federal Bureau of Statistics (FBS), Government of Pakistan (GoP) and the State Bank of Pakistan (SBP) are two focal points for collecting data on the services sectors of Pakistan. Even though the FBS follows the age-old tradition of data collection on services on the lines of the System of National Accounts developed by the United Nations, yet the SBP has taken the initiative to compile the data on the Balance of Payments Statistics adapted from the Fifth IMF Balance of Payments Manual. In this regard, SBP has started publishing statistics on the basis of extended balance of payments system (EBOPS), which also covers 11 service sub-sectors [SBP (2006)].[1]

As shown in Table 1, the importance of the services sector to Pakistan's economy has grown considerably during the last three and a half decades whereby the services share (including construction; electricity and gas distribution) in GDP has increased from 44.8 per cent in FY1969-70 to 57.5 per cent in FY2005-06.[2] This increase is accounted for by a relative decline in

[1] For further details on sectors covered under EBOPS, see Table 4.
[2] The FBS national accounts data only gives aggregated statistics on the services sector of Pakistan.

Table 1: Sector-wise Share in GDP at Constant Factor Cost

| | 1969-70 | 2001-02 | 2002-03 | 2003-04 | 2004-05 | 2005-06 |
|---|---|---|---|---|---|---|
| **Commodity Producing Sector** | **61.6** | **47.9** | **47.1** | **48.4** | **48.7** | **47.7** |
| 1. Agriculture | 38.9 | 24.1 | 24.0 | 22.9 | 22.5 | 21.6 |
| 2. Mining & Quarrying | 0.5 | 2.4 | 2.5 | 2.6 | 2.7 | 2.6 |
| 3. Manufacturing | 16.0 | 15.9 | 16.3 | 17.3 | 17.9 | 18.2 |
| 4. Construction | 4.2 | 2.4 | 2.4 | 2.0 | 2.1 | 2.2 |
| 5. Electricity & Gas Distribution | 2.2 | 3.0 | 2.4 | 3.7 | 3.5 | 3.0 |
| **Services Sector** | **38.4** | **52.1** | **52.3** | **51.6** | **51.3** | **52.3** |
| 6. Transport, Storage & Communications | 6.3 | 11.4 | 11.4 | 10.9 | 10.4 | 10.5 |
| 7. Wholesale & Retail Trade | 13.8 | 17.8 | 18.0 | 18.2 | 18.6 | 19.2 |
| 8. Finance & Insurance | 1.8 | 3.5 | 3.3 | 3.4 | 4.0 | 4.6 |
| 9. Ownership of Dwellings | 3.4 | 3.2 | 3.1 | 3.0 | 2.9 | 2.8 |
| 10. Public Administration & Defence | 6.4 | 6.4 | 6.6 | 6.3 | 5.6 | 5.8 |
| 11.Other Services | 6.7 | 9.8 | 9.9 | 9.7 | 9.5 | 9.5 |
| **GDP (constant factor cost)** | **100.0** | **100.0** | **100.0** | **100.0** | **100.0** | **100.0** |

Source: GoP (2006)

the share of agriculture that has fallen from 39 per cent in FY1969-70 to 22 per cent in FY2005-06 while the share of manufacturing and mining sectors have both posted increase in the corresponding period.

Growth performance of Pakistan’s economy deteriorated in the 1990s when as against an average growth of 6.1 per cent in the 1980s, real GDP growth slowed down to 4.6 per cent in the 1990s (Table 2). Against this backdrop, the economy of Pakistan has grown at an average rate of 7 per cent per annum during the last four years and over 7.5 per cent over the last three years. With this growth performance Pakistan rubs shoulders with the exclusive club of the fastest growing economies of the Asian region in recent years. As shown in Table 2, the services sector of Pakistan has been a major contributor to the overall growth in GDP with its

Table 2: Growth Performance of Selected Sectors of Pakistan’s Economy

(% growth at constant factor cost)

| | 1980’s | 1990’s | 2002-03 | 2003-04 | 2004-05 | 2005-06 |
|---|---|---|---|---|---|---|
| **Commodity Producing Sector** | **6.5** | **4.6** | **4.3** | **9.2** | **9.2** | **4.3** |
| 1. Agriculture | 5.4 | 4.4 | 4.3 | 2.3 | 6.7 | 2.5 |
| 2. Mining & Quarrying | 9.5 | 2.7 | 6.6 | 15.6 | 9.6 | 3.8 |
| 3. Manufacturing | 8.2 | 4.8 | 6.9 | 14.0 | 12.6 | 8.6 |
| 4. Construction | 4.7 | 2.6 | 4.0 | -10.7 | 18.6 | 9.2 |
| 5. Electricity & Gas Distribution | 10.1 | 7.4 | -11.7 | 56.8 | 3.5 | -8.4 |
| **Services Sector** | **6.6** | **4.6** | **5.2** | **5.9** | **8.0** | **8.8** |
| 6. Transport, Storage & Communications | 6.2 | 5.1 | 4.3 | 3.5 | 3.6 | 7.2 |
| 7. Wholesale & Retail Trade | 7.2 | 3.7 | 5.9 | 8.4 | 11.1 | 9.9 |
| 8. Finance & Insurance | 6.0 | 5.8 | -1.3 | 9.0 | 29.7 | 23.0 |
| 9. Ownership of Dwellings | 7.9 | 5.3 | 3.3 | 3.5 | 3.5 | 3.5 |
| 10. Public Administration & Defence | 5.4 | 2.8 | 7.7 | 3.2 | 0.6 | 4.7 |
| 11.Services | 6.5 | 6.5 | 6.1 | 5.6 | 5.9 | 6.5 |
| **GDP (constant factor cost)** | **6.1** | **4.6** | **4.7** | **7.5** | **8.6** | **6.6** |

Source: GoP (2006)

remarkable real rate of growth averaging 7 per cent over the past four years while major growth occurring only in the last two years at the rate of 8 per cent or more.

Table 3 illustrates that similar to value added shares in Table 1, services are assuming the role of a new growth powerhouse in the country by contributing bulk of growth. More specifically, while the relative share of services in growth has gone up, in FY2005-06 alone 68.3 per cent contribution to GDP growth came from the services sector and the rest of the contribution to real GDP growth, or 31.7 per cent, came from the commodity producing sectors.

Table 3: Sector-wise Contribution to the GDP Growth (% points)

| Sector | 2002-03 | 2003-04 | 2004-05 | 2005-06 |
|---|---|---|---|---|
| Agriculture | 1.04 | 0.55 | 1.54 | 0.55 |
| | [21.98] | [7.35] | [17.97] | [8.32] |
| Industry | 1.01 | 3.84 | 2.91 | 1.54 |
| | [21.35] | [51.34] | [33.96] | [23.30] |
| Services | 2.69 | 3.09 | 4.12 | 4.51 |
| | [56.87] | [41.31] | [48.07] | [68.23] |
| GDP (constant factor cost) | 4.73 | 7.48 | 8.57 | 6.61 |

Note: Numbers in square brackets are sector-wise percentage shares in real GDP growth.
Source: GoP (2006)

The fastest growing services sub-sectors in Pakistan are finance and insurance; wholesale and retail trade; and transport and communications (see Table 2). Growth and efficiency gains witnessed in finance and insurance can be attributed to financial reforms and liberalization initiated in the 1990s. The efficiency gains of banks and non-bank financial institutions (NBFIs) point at the highly competitive market structure where state-owned, private and foreign banks and NBFIs compete by rationalizing their relative costs structure and by introducing new financial products. This competitive environment in the financial market has in turn helped financial institutions to raise their profits in recent years. In other words, the economic benefits of financial liberalization and reforms that were not as obvious in the adjustment period in the 1990s have now started yielding dividends. As an ancillary development, insurance business in Pakistan, after remaining stagnant for a long period of time, has also seen a sharp rise in activity as indicated by 15 per cent increase in their asset base during CY2005, which is shared by both non-life and life insurance sector. The growth in the non-life sector is attributed to enhanced international trade, commerce and bank borrowing, which has created substantial demand for non-life insurance.

Wholesale and retail trade; and transport, storage and communication services together contribute 57 per cent of total services production in Pakistan (see Table 1). However, due to highly labour-intensive nature of wholesale and retail trade, its contribution to the economy is even more important than what its 36.7 per cent share in total services trade obviously suggests. Given that the share of this sub-sector is increasing overtime (Table 1), its higher growth is not only important for employment generation in the country, but is also critical for the efficiency of the economy because through forward and backward linkages it reflects performance in agriculture, manufacturing and foreign trade sectors. With rationalization of import tariff regime in the country whereby the average tariff rates have come down from 55 per cent in 1995 to 17 per cent in 2004 have obviously influenced the volume of international trade in the country [Schuler (2004)].

Another sub-sector where strong growth was witnessed is transport, storage and communication from where major contribution to value added comes and which shows linkage with production and foreign sectors. The transport head covers roads, railways, air transport, port and shipping services, but moderate growth in this sector sometimes overshadows strong growth posted by communications that comprises of telecommunication, IT and postal services. Strong growth momentum in the communication sector, like the financial services and wholesale and retail trade was triggered by liberalization and reforms. For example, deregulation policy for this sector and market driven reforms created a huge demand for new products which were instrumental in attracting new foreign investment by new telecom companies in cellular phones. With entry of two new cellular operators namely, Al-Warid and Telenor, competition in the cellular market segment has become even tougher leading to improvement in service quality and further reduction in tariffs to the advantage of consumers. Privatization of the state-owned utility PTCL in 2006 has further augmented this competitive environment.

### 3.3 Services Sector Activities Traded Internationally including FDI

Due to deficiencies in services statistics mentioned above, measuring services exports and imports for countries like Pakistan is an extremely difficult task due in part to rapidly changing boundaries between services and industry, and due to ambiguous and outdated services classification systems in vogue. However, the SBP balance of payments statistics being compiled from November 2003 on the basis of Fifth IMF Balance of Payments Manual does provide statistics on services trade. As shown in Table 4, EBOPS covers 11 service sub-sectors.

Table 4: Services Exports and Imports (in US$ million)

| Sector | FY2003-04 | | FY2004-05 | | FY2005-06 | |
|---|---|---|---|---|---|---|
| | Exports | Imports | Exports | Imports | Exports | Imports |
| 1.Transportation | 864 | 1754 | 1062 | 2280 | 1066 | 2856 |
| 2.Travel | 164 | 1198 | 177 | 1172 | 216 | 1401 |
| 3.Communication services | 204 | 38 | 331 | 59 | 198 | 101 |
| 4.Construction services | 12 | 18 | 24 | 6 | 16 | 143 |
| 5.Insurance services | 19 | 81 | 25 | 101 | 29 | 127 |
| 6.Financial services | 21 | 77 | 39 | 77 | 70 | 133 |
| 7.Computer and Information services | 41 | 12 | 47 | 27 | 71 | 41 |
| 8.Royalties and license fees | 10 | 47 | 13 | 117 | 33 | 100 |
| 9.Other business services | 202 | 534 | 285 | 2502 | 391 | 2943 |
| 10.Personal, cultural and recreational services | 1 | -- | 1 | 7 | 1 | 6 |
| 11.Government services, n.i.e. | 1106 | 201 | 1315 | 274 | 1657 | 298 |
| All services receipts | 2644 | 3960 | 3319 | 6592 | 3748 | 8149 |
| Share in GDP | 3.8% | 5.6% | 4.3% | 8.6% | 4.6% | 10.1% |
| Share in total exports of goods and services | 17.5% | 26.2% | 18.6% | 37.2% | 18.5% | 40.2% |

Note: Other business services refer to operations of missions/representations (foreign in Pakistan, Pakistani missions abroad), royalties, bank commissions and charges, technical/legal fees, and sundry insurance payments.

Source: Calculated from SBP, Annual Report FY2005 & FY2006

Due to smaller scale of services trade, Pakistan is not only considered as amongst the small service providers/traders of the region, but also its imports of services (payments) are growing at a faster pace than its exports (receipts) of services. Total transactions in services had reached close to $10 billion in FY2005 (Table 4). Major exports in services are government services, transportation, communication, and business services. Table 4 underlines the importance of services as tradable goods for which the country need to explore ways by which the comparative advantage in services could be explored rather than solely relying on commodity producing sectors. It goes without saying that remittances of Pakistani workers abroad amounting US$ 3.87 billion in FY 2004 and US$ 4.17 billion in FY2005 [see GoP (2006)] are not part of this data, which if included as part of Mode 4 transactions would give a respectable look to the services trade data.

Overall, services sector accounted for some 60 per cent of the stock of FDI in FY2004-05 (see Table 5). Communication and financial business services alone account for more than 50 per cent of total FDI. While FDI increased by 60.5 per cent as compared with FY2004, a large part of this increase was due to privatization proceeds in communication and financial sectors.

Table 5: Foreign Direct Investment

(million US $)

| | FY2003-04 | FY2004-05 | Share in total | Growth |
|---|---|---|---|---|
| Food & Beverage | 4.0 | 16.2 | 1.1 | 305.0 |
| Textiles | 35.4 | 39.3 | 2.6 | 11.0 |
| Chemicals | 15.3 | 51 | 3.4 | 233.3 |
| Petroleum Refining | 70.9 | 23.7 | 1.6 | -66.6 |
| Oil & gas exploration | 202.4 | 193.8 | 12.7 | -4.2 |
| Pharma & OTC products | 13.2 | 38.0 | 2.5 | 187.9 |
| Machinery & electronics | 16.9 | 16.5 | 1.1 | -2.4 |
| Transport equipment | 3.3 | 33.1 | 2.2 | 903.0 |
| Power | -14.3 | 73.3 | 4.8 | 616.2 |
| Construction | 32.0 | 42.7 | 2.8 | 33.4 |
| Trade | 35.6 | 52.1 | 3.4 | 46.3 |
| Communication | 221.9 | 517.6 | 34.0 | 133.3 |
| Financial Business | 242.1 | 269.4 | 17.7 | 11.3 |
| Others | 70.6 | 157.3 | 10.3 | 122.8 |
| **Total** | **949.4** | **1524.0** | **100** | **60.5** |

Source: SBP, Annual Report 2004-05

### 3.4 Share of Services Sector in Employment Generation

Estimates show that Pakistan with 2.5 per cent of world total population is ranked as 6th most populous county in the world after China, India, USA, Indonesia and Brazil (see Table 6). Despite a declining population growth rate from 3.5 per cent in FY1982 to 1.9 per cent in FY2005, Pakistan is maintaining the highest population growth rate amongst the most populous countries. The projections till 2050 show that Pakistan would be ranked ahead of Brazil as 5th most populous country.

A stylized fact of economic development as noted by Francois and Reinert (1996) is that the share of services in GDP and employment rises with rising per capita income thus reflecting increased specialization and market exchange through outsourcing of activities by the commodity producing sectors. While the share of services sector in Pakistan's GDP has increased with rising per capita income, the same increase has not occurred in the share of

Table 6: Pakistan's Population Ranking in the World

(Population in million)

| Year | Rank | Population |
|---|---|---|
| 1950 | 14 | 33 |
| 1981 | 10 | 84 |
| 2001 | 7 | 143 |
| 2005 | 6 | 154 |
| 2050 | 5 | 295 |

Source: 2005 World Population Data Sheet, Population Reference Bureau, Washington, D.C.

services in employment. It reflects poorly on the poverty alleviation potential of growth in the services sector because it offers limited scope for employment of labour in provision of these services. The disproportionate increase in the share of services to employment to its share in value-added to the economy seems to indicate that this growth has mostly occurred in knowledge-based service sub-sectors. In other words, service industries are increasingly relying on IT that makes them more dependent on capital equipment and human-capital inputs, which are more skill-intensive in nature.

The share of services sector in employment, which remained stable at around 47.2 per cent between 1995 and 2000, has consistently fallen in recent years. As shown in Table 7, the services sector share (including construction; and electricity and gas distribution) in employment has considerably fallen from 40.03 per cent in FY1999-00 to 37.4 per cent in 2003-04 and to only 35.7 per cent in FY2005-06. Except for a marginal increase in the share of transport, storage & communication, employment share of all other services sub-sector has decreased.

Table 7: Distribution of Employed by Major Industry Divisions

| Major Industry Division | FY2003-04 | FY2005-06 |
|---|---|---|
| **Commodity Producing Sector** | **62.6** | **64.4** |
| Agriculture, forestry, hunting & fishing | 43.1 | 44.8 |
| Manufacturing | 13.7 | 13.7 |
| Construction | 5.8 | 5.9 |
| **Services Sector** | **37.4** | **35.7** |
| Wholesale & retail trade | 14.8 | 14.1 |
| Transport, storage & communication | 5.7 | 5.8 |
| Community, personal and social services | 15.0 | 13.8 |
| Others | 1.9 | 2.0 |
| Total | 100 | 100 |

Source: Labour Force Survey 2003-04

The agriculture sector keeps on absorbing about 45 per cent of total employed labour force in the country despite the fall in agriculture sector's share in the value-added to the economy. By far, wholesale and retail trade; community, personal and social services; and transport, storage and communication services have been leading service sectors employing additions to the labour force. The construction sector and agriculture sectors are the other two sectors where positive employment growth has occurred during the last two years.

# 4. THE STATE OF SERVICES IN CHANGING POLICY ENVIRONMENT

## 4.1 Introduction

The generic policy for growth and development of the services sector of Pakistan is built around the knowledge economy where competition is the key strategy where firms have liberal operating rights, and regulators are separate from the operators. This policy towards the services sector is premised in the Medium-term Development Framework 2005-10, which envisages a sustained average growth rate of 6.9 per cent per annum in the combined output of services. While the prerequisites recognized for a vibrant service sector are good infrastructure; ability to plan and complete logistics chain; mobilization of human resources and entrepreneurial capacity; communication skills, the physical convergence of all these activities is expected to take place at the level of Small and Medium Enterprises (SMEs), where employment generation takes place. There has been policy discussion on some new opportunities opening up or where Pakistan has a comparative advantage. However, it needs to be seen how Pakistan takes full advantage of the exciting new opportunities that are opening up in services trade.

While services are still identified with the line ministries and government departments, there is increasing recognition amongst the policy makers for improved level of skills in many sectors and for departure from the inward looking policies. In view of the dramatic changes in the services sector, regulatory and policy issues have continued to gain importance in the policy-making circles for the last 15 years.

## 4.2 State Intervention in an Historical Perspective

Pakistan has a long history of state interventions in the commodity producing and service sectors where import substituting industrialization has been the hallmark of policy in the 1950s and 1960s. In this era, state intervention in goods and factor markets set the pace and structure of industrial and agricultural development in the country discriminating between large and small firms in the private sector, which was supported by a stringent regulatory regime consisting of macroeconomic (fiscal, monetary and exchange rate) and trade policies [Papanek (1967), Lewis (1969)]. However, there was a significant shift in focus of state policies in the 1970s away from the large private sector firms to the public sector. As part of the new policy 10 big industries and all banks and insurance companies were nationalized in early and mid-1970s followed by major public sector investments in capital-intensive intermediate and capital goods industries including manufacturing, energy, and the banking and insurance sectors.

After 1978, in an attempt to restore the confidence of the private sector on the market place, some of the nationalized industries were returned to their original owners by the new government. While state intervention continued in the 1980s, the empirical evidence shows that interventions in factor markets had promoted allocative inefficiency leading to higher cost of production for the manufacturing firms [Burki and Khan (2004)].[3] Up until the early 1990s, the incentive structures for the agriculture sector were also influenced by pricing, trade and the exchange rate policies leading to highest incidence of indirect taxation of the agriculture sector.[4]

State involvement has also remained strong in the services sector of Pakistan. Due to large state presence in services, private or foreign participation has been non-existent or limited to a few sectors. Consequently, telecommunication services were often inaccessible and were of poor quality. Until 2003, Pakistan's telecommunications market for fixed-line services was a virtual monopoly in the hands of the Pakistan Telecommunication Company Ltd. (PTCL).

In the banking sector, five nationalized commercial banks (NCBs) dominated the scene in providing financial intermediation services from 1972 to 1990 and holding 92 per cent share in total banking assets while foreign commercial banks holding the rest [SBP (2003)]. In transport, two state-owned organizations had near or complete monopoly in passenger or freight transport. Pakistan Railways had near monopoly in passenger and freight transport while Pakistan International Airlines had a complete monopoly on domestic air passenger and cargo traffic. All ports and airports were also state-owned and state-run. In the energy and mining sector, several state-owned or partially state-owned utilities dominated generation, distribution and marketing of electricity, oil and gas, and storage of petroleum and petrochemical products. All services relating to sanitation, sewage, refuse disposal and clean drinking water were owned and operated by federal, provincial, district, tehsil level governments or municipalities.

### 4.3 From State Intervention to Privatization, Liberalization and De-regulation

Pakistan initiated a series of structural reforms starting from the early 1990s with a key element of reforms being privatization of state-owned enterprises (SOEs), and liberalization and deregulation of the factor and product markets. These measures seem to have paid-off in the long-run by benefiting the commodity producing sectors, services and utilities equally. Since then the services and utilities have faced a series of reforms purely because of domestic structural problems.

Privatization in Pakistan has been used as an important economic reform policy tool since January 1991 when an independent Privatization Commission was set up to minimize state involvement in commercial activities. The privatization has also served as a tool for structural adjustment of the economy and to promote competition by removing unnecessary barriers. Along with deregulation and good governance, the privatization process has been used to

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[3] Prior beliefs suggest that stringent state regulatory regime in a country results in misallocation of scarce resources. Consistent with these beliefs, Burki et al. (1997) show that before 1992 manufacturing firms in Pakistan over-utilized scarce capital and under-utilized abundant labor. Moreover, misallocation of resources increased cost of production of firms at the rate of one percent per annum thus making them at a competitive disadvantage [Burki and Khan (2004)].

[4] For example, Schiff and Valdes (1992) have noted that by maintaining pre-determined output prices well below border-parity prices, Pakistan has been able to maintain one of the highest rates of indirect taxation of the agriculture sector in the world.

increase productivity in the economy by bringing the private sector at the forefront of this endeavour.

Due to lack of adequate regulatory framework and enabling environment, while the privatization process has remained slow until 1999, it has moved at a much faster pace since 2000 with the strengthening of the legal authority to the Privatization Commission. Under the privatization program during January 1991 to April 2006, 160 units have been privatized with earnings of Rs.395.2 billion (or more than US$6.5 billion in 2005-06 prices), which included 57 transactions completed only after 1999 amounting to Rs.337.9 billion (or US$ 5.6 billion).

The initial mandate to the Privatization Commission was only to privatize industrial units, but by 1993 this coverage was expanded to include power, oil and gas, transport (aviation, railways, ports and shipping), telecommunication, banking and insurance sectors. Some of the key producer services that have been privatized recently include transactions in banking, telecom, power, and oil and gas sectors. The privatization of some huge state-owned entities in the oil and gas sector is currently in process including Pakistan State Oil Company (PSO), Pakistan Petroleum Limited (PPL), Oil and Gas Development Company Limited (OGDC) and Faisalabad Electric Supply Company (FESCO).

## 4.4 Current State of Key Services and Liberalization

*Reforms in the Banking and Finance Sectors*

Since 1990, Pakistan's Central Bank, the State Bank of Pakistan has pursued reforms in the financial sector of Pakistan with focus on liberalization, competition, privatization of state-owned banks, and institutional strengthening [SBP (2003)]. As part of liberalization, new private and foreign banks have been granted permission to operate and extend operations. Competition has also been introduced by privatization of government owned banks with transfer of ownership and/or control to the private sector. There are no restrictions on the establishment and operations of foreign banks. As a result, merger and acquisition of private and foreign banks by existing or new groups have increased in recent years. These reforms have not only helped in promotion of competition but also in deepening of the financial sector.

Interest rate regime has been deregulated and prudential regulations and independent supervision has been strengthened. Due to the dynamic role of foreign and private banks, the share of state-owned banks in bank deposits have gradually declined from 93 per cent in 1990 to only 56 per cent in 2000 while the share of private banks have increased from zero to about 30 per cent in the same period. More recently, the profits of the banking sector have increased after their venturing into consumer finance and housing finance. By changing the general business environment in which banks operated, the financial reforms have increased the efficiency and productivity of these banks. In particular, improved bank management practices due to enhanced competition and prudential regulations have been most significant in determining their comparative efficiency [Burki and Niazi (2006)]. While the insurance sector is an important component of the financial sector of Pakistan, it is facing issues relating to legislation, reinsurance and taxation.

*Reforms in the Telecom Sector*

The liberalization and reforms launched in various telecom sub-sectors have enhanced the private sector participation and contributed to faster growth of the telecommunication activities in Pakistan. Since 1996, two state companies National Telecommunication Corporation and Pakistan Telecommunication Company Ltd (PTCL) had monopoly control on fixed-line domestic and international services. The PTCL monopoly ended in 2003 while the management of the company has been given to the telecom giant of the United Arab Emirates Etisalat in 2006 after it won the bid for 26 per cent of shares of the state-owned PTCL.

Since 2000, Pakistan has experienced rapid growth in the telecom sector in terms of quality, variety, and subscriber base. In effect, lower cost of telecom services, high quality and improved customer services have fuelled this growth. Private sector has been increasingly involved in development and expansion of mobile telephony, paging, card-operated telephone, internet services, wireless local loop, and fixed local loop services. The telecom reforms have effectively promoted a competitive market structure leading to increased consumer choices and reduction in prices of telecom services. The cellular mobile sector is most thriving since liberalization. About 1.6 million new cellular subscribers were being added in each month. Mobile subscribers have continued to rise at an unprecedented pace reaching 30 million by April 2006. Similarly, the overall teledensity in the country has jumped from only 2.3 per cent in 1999-2000 to 23.1 per cent by April 2006, which is much higher than the teledensity in India at 12.8 per cent. Rules concerning foreign investment in the telecom sector have been made fairly liberal allowing 100 per cent foreign ownership of equity and repatriation of profits in all segments.

*Policy Framework in Construction and Architectural Services*

The construction sector represents a fundamental activity with strong forward and backward linkages. Growth in this sector is critical for growth in GDP and employment in the country. Majority of registered contractors are small or medium firms who use primitive labour-intensive construction work processes and have weak organizational structures and financial positions. Most of the registered contractors in Pakistan are illiterate who lack vision for growth and development of the construction industry. Mechanized and state of the art construction processes are wilfully avoided by small players on account of cost considerations due to plentiful availability of cheap labour.

Side-by-side some highly sophisticated public and private sector engineering firms also exist in Pakistan, which are mostly involved in large earth works, civil engineering, commercial construction, real estate development, architecture, engineering and related engineering services. Small and medium firms are involved in small building plans, small bridges and roads, although larger firms have relative comparative advantage in mega projects. State of the art technology and specialization of these firms allows these companies also to compete internationally, especially in the Middle East. Most engineering and construction firms generally provide project related services while only a few market players also have the capacity and resources to provide all services, e.g., NESPAK[5] and Frontier Works Organization (FWO) in the public sector, and Descon Engineering[6] in the private sector.

Market access for commercial presence is fairly open to bid for government contracts. In this regard, several Chinese public or private sector companies, Turkish companies and Korean companies have from time-to-time operated in construction or civil engineering works. Entrance of foreign construction and engineering firms has enhanced competition in their bid for mega projects. Moreover, various foreign companies of the Middle East or South East Asia origin are also involved in developing real estate projects in association with some Pakistani companies due to joint venture restrictions.

Ironically, the policies relating to construction services come from various line ministries, departments and regulatory bodies. For example, the Ministry of Housing and Works[7] is mandated to oversee most construction and engineering related legislation and to initiate policies after inter-ministerial consultations. However, the Pakistan Engineering Council (PEC)[8] is the regulatory body established by the Act of Parliament of Pakistan in 1976, which regulates engineering education, gives certification to professional engineers and advises government on all engineering and construction related issues. Moreover, all construction and engineering related firms are required to be licensed by PEC to operate in the country. PEC registers constructors and operators into three categories namely, C1, C2 and C3, which is based on the minimum paid-up capital requirement indicating a firm's sound financial and technical capacity. From more than 24,000 constructors and 88 operators registered with PEC, only close to 600 qualify to the C1 category (largest contractors/operators) on the basis of a benchmark of Rs.20 million average annual value of work undertaken during the past three years [Saeed et al. (2005)]. The foreign engineering consultancy service providers are also subject to the regulations of PEC.

The Pakistan Council of Architects and Town Planners (PCATP)[9] is another governing body established by the government to regulate the profession of architecture, which not only sets standard of conduct for its own members, but also advises government on architectural issues facing the industry. Even though, there are no solely owned foreign architectural firms in Pakistan, JGC-Descon Engineering (Pvt) Limited[10] is a joint venture company of Descon Engineering (49 per cent equity) with a leading Japanese company JGC Corporation, Japan (51 per cent equity) geared up to produce engineering and architectural designs for the global market. Foreign architectural firms seeking MA into Pakistan are subject to the condition of registration with PCATP.

At another level, the construction and architectural services are subject to the by-laws of local governments. Hence each city district development authority has its own independent regulatory body to regulate construction plans and designs in their jurisdiction. But, there is no consistency in rules and regulations across cities due to lack of coordination between the federal and local governments. In addition to the above, the National Highway Authority[11] is mandated to

[5] www.nespak.com.pk
[6] www.descon.com.pk
[7] www.pakistan.gov.pk/ministries/index.jsp?MinID=23&cPath=272
[8] www.pec.org.pk
[9] www.pcatp.org.pk
[10] www.jgc-descon.com.pk
[11] www.nha.gov.pk

regulate construction of highways and elevated highways all over the country. Further, the Pakistan Housing Authority[12] in the Ministry of Works has been set up to construct low cost apartments for the middle- and low-income families.

In sum, construction work processes are generally too primitive and they need to change as soon as possible. Current regulations governing construction, engineering and architectural engineering services have several tiers. These regulations are highly diversified and their implementation is mostly lax in nature. Pakistan need to revamp its multi-tiered regulatory framework in construction, engineering and architectural sectors before this sector is ready to cope with the risks of liberalization.

*Policies and Reforms in the Energy Sector*

The oil and gas sector of Pakistan is largely controlled by the state through interventions in pricing, allocations, returns and other administrative controls. Market access through commercial presence is allowed to private and foreign investors in oil and gas sectors. While multinational companies (MNCs) are involved in oil and gas exploration, several state-owned or partially state-owned companies dominate the oil and gas sector. They include PSO which is involved in marketing, storage and distribution of petroleum and petrochemical products. Similarly, the Sui Northern Gas Pipelines Ltd and the Sui Southern Gas Company Ltd are in transmission, purification and distribution of natural gas. Likewise, Pakistan Petroleum Ltd is the largest exploration and production company while the Attock Refinery Ltd. and Pakistan Oilfields Ltd are two other state-owned companies.

Most oil refineries are owned and operated by the private sector in which government is seeking further FDI. In marketing of petroleum products, although the state-owned PSO still holds a major market share, few other multinationals or private companies also compete in the market. Contrary to the oil sector, gas distribution is a state monopoly where no MA is present to private or foreign players. While partial privatization of the two state-owned companies is underway, it will however leave the control of the companies in the hands of the government.

The challenge facing the oil and gas sector is that liberalization may not result into a competitive market structure. Although, huge infrastructural investments in oil distribution would serve as barrier to entry, yet gas distribution is a natural monopoly. The Oil and Gas Regulatory Authority (OGRA)[13] has been set up to oversee oil and gas sector, which is an important departure from the past. The OGRA faces a formidable challenge that how privatization of natural gas distribution network brings about a competitive market structure.

The country's power sector is growing at the rate of 10-12 per cent per annum. Up until 1994, the power sector of Pakistan was completely under state control. The Water and Power Development Authority (WAPDA)[14], the Karachi Electric Supply Corporation (KESC)[15], Karachi Nuclear Power Plant, and Chashma Nuclear Power Plant were the four public sector

[12] www.pha.gov.pk
[13] www.ogra.org.pk
[14] www.wapda.gov.pk
[15] www.kesc.com.pk

entities involved in power generation, transmission and distribution of electricity. However, the Power Policy 1994 liberalized the power generation sector with the introduction of Independent Power Projects (IPPs). Under the 1998 privatization/deregulation reforms WAPDA was vertically and horizontally unbundled into a) generation companies; b) transmission and dispatch companies; and c) distribution companies.

In power generation, there are no MA limitations for commercial presence (Mode 3) to private or foreign companies. International competitive bidding is being used to attract private power generating plants (GENCOs). The Private Power and Infrastructure Board (PPIB) provides one-window opportunity to the investors. More recently, investment procedures for GENCOs have been simplified. Presently, 16 IPPs are generating 6500 MW electricity under the power purchase agreement while the existing availability of power in the country is 13,500 MW. But IPPs are not involved in transmission and distribution of electricity.

Market access limitations on private and foreign firms are still present in power transmission, although substantial reduction in MA limitations is on the cards in power distribution. Eight state-owned distribution companies, created after unbundling of WAPDA, are in the process of privatization. The NTDC is the national grid company, which purchases power from the IPPs on behalf of eight distribution companies (DISCOs) by employing Economic Load Dispatch criteria on fuel prices.

Another state-owned company - KESC - involved in power generation, transmission and distribution in Karachi city was fully privatized in 2005. The KESC has been running into losses somewhere in the range of Rs.1 billion a month to the exchequer for more than a decade before the ownership of the utility was switched over from the state to the private sector. The management control of the KESC was handed over by the government to the new owners in November 2005 with government holding of 73 per cent. While the utility posted after tax losses in the staggering sum of Rs.11 billion (US$ 4183 million) for the 15 month period from July 2005 to September 2006, the full year results for 2005 were even worst, which indicate that there is a brighter side to privatization.

The power sector has an age-old infrastructure, which is in need of major investments. Moreover, electricity pricing is not based on cost of service, which has to change sooner than later. Cross-subsidization is also quite common. The National Electric Power Authority (NEPRA)[16] is the sector regulator, which has limited capacity to withstand government pressure, especially on issues of electricity pricing. Moreover, severe human capital constraints also remain a major challenge for NEPRA. To promote more responsible and efficient use of energy resources in the country, it is imperative that the institutional capacity of NEPRA is enhanced.

There is the opportunity of better service quality after major infrastructural improvements through use of new technology. Moreover, increased MA in generation and distribution would provide further opportunities for FDI in this sector. Electricity consumers, NEPRA, WAPDA/KESC, GENCOs and DISCOs are some of the stakeholders in this sector.

[16] www.nepra.org.pk

*Environment Policy and Regulatory Framework*

Pakistan has an elaborate policy framework to deal with environmental services. Some of the policies governing this sector include Pakistan Environmental Protection Act (PEPA) enacted in 1997, National Environmental Policy, National Sanitation Policy, National Drinking Water Policy and guidelines for solid waste management. The national regulatory agencies dealing in this sector for the implementation of PEPA at the federal level are Pakistan Environmental Protection Agency (Pak-EPA)[17], which was created as part of the Environmental Protection Act, 1997. Pak-EPA plays a major role in framing environmental policy in the country by working closely with the GoP and the private sector in the policy formulation process. The provincial environment protection departments are Pak-EPAs counterparts in the provinces. Pak-EPA also has the function to help local government, government agencies and other persons to implement schemes and to help increase compliance with the established environmental standards.

To ensure uninterrupted supply of municipal services has always remained a major public policy objective, which is not likely to change in a foreseeable future. The reason being that ensuring cleaner municipal environment is not only costly, but also it generates a public good. Due to negative externalities associated with prolonged interruptions of these services, local governments often shy away from reliance on others. Moreover, being public good most citizens would not internalize the cost of cleaning. In effect, it presents a classic case of market failure, which justifies active government involvement and subsidy. Because the poor are even less likely than the rich to bear any private cost of cleaning services, it is not surprising to find that such services are often subsided to maximize welfare.

Likewise, most municipal services in Pakistan are either delivered free of charge or at a nominal fee. Some of these services include sewage services; refuse disposal services; sanitation and similar services; and piped water facilities. One of the major challenges for civic bodies is to deal with increasing urbanization, which has led to a virtual collapse of sewerage and solid waste management services in major cities. It is estimated that only 50 per cent of waste quantity generated is collected by government owned and operated services in Pakistan's cities while for the cities to look cleaner at least 75 per cent of the solid waste should be collected.[18] Further, the estimates also show that about 55000 tons per day of solid waste is generated in Pakistan, which is growing at a rapid pace due to social and economic development. If only half of this waste is reaching final disposal sites, it poses a major health hazard to the urban population. While solid waste is mostly handled in a primitive fashion involving no weighing facility, sampling and analysis. The physical composition of waste differs across cities based on the level of development. Cities with more traditional lifestyles generate much less waste than metropolitan cities. Another serious health hazard arises when hospital and industrial waste is treated just like an ordinary waste. The proportion of waste collection also varies across municipalities depending upon their efficiency. The scavengers are also an important part of solid waste management because they are instrumental in separating recyclable materials.

[17] www.environment.gov.pk

[18] See Brief on Sold Waste Management in Pakistan available at <www.environment.gov.pk/PRO_PDF/PositionPaper/Brief-SWM-%20Pak.pdf (accessed on March 10, 2007)

At the federal level Planning and Development Division and at the provincial level Planning and Development Departments are the responsible bodies, which make plans and allocate resources. However, PEPA and provincial EPAs are responsible to regulate the sector in line with Pakistan Environmental Protection Act, 1997. Even though municipal governments are often responsible for collection and disposal of solid waste, they are becoming increasingly under-resourced to cope with the challenge of continuously increasing volumes of solid waste. After devolution of local government system Town/Tehsil Municipal Administration (TMAs) are primarily responsible to collect, transport and dispose-off solid waste. The existing infrastructure needs major investment, but most city district governments are faced with severe financial constraints, which hinder their efforts to improve the quality of these services. City district governments and TMAs may not be able to withstand public pressure for a longer period for demands of improved service quality in civic services. Private sector service delivery may be an option that may provide solutions to these problems. However, an important policy issue in this regard is the pricing of these services. Moreover, the institutional framework required for such a transition is also not available.

In some metropolitan cities, their has been some selective sub-contracting of waste management services to the private sector, especially in waste collection and its recycling. In this regard, a private waste management company Waste Busters has acquired significant stakes by forming joint ventures with city district government of Lahore. Similarly, Lahore Compost Plant is also a joint-venture between city district government Lahore and a private company for managing recycling of waste. Some private-public initiatives to build land fill sights are also in the offing. However, these sub-sectors are not open to commercial presence of foreign firms. There is no move yet by Pak-EPA to formally initiate liberalization of these services even though several elected representatives of the civic bodies are forthcoming in forging alliances with the private sector.

Unlike civic services, there are more than two dozen private firms involved in providing environmental services ranging from environmental impact assessment to environmental consulting services. Since the enactment of National Environmental Quality Standards (NEQS), the demand from manufacturing industry for cleaner technologies and for other environmental services has sharply increased leading to a mis-match between demand and supply of these services. It is quite common for environmental consulting firms in Pakistan to collaborate with foreign consultants and firms. These collaborations are producing healthy results mainly because Pakistan is facing shortage of qualified engineers who can provide environmental consulting services.

In general, Pakistan has a strong import interest in most environmental services. While liberalization of this sector is important for the government to meet its various environmental objectives, it also offers opportunities in the form of better quality of service which in addition to its human capital value is also important due to the possibility of technology transfer. How the government should allow free market in a sector that has hitherto been closed remains to be explored.

# 5. PAKISTAN'S EXISTING URUGUAY ROUND COMMITMENTS

## 5.1 Introduction

The on-going request-offer process in the Doha Round of negotiations builds on Pakistan's existing Uruguay Round horizontal and sector specific commitments. In this section we highlight scheduled limitations to market access and national treatment in some specific sectors to better understand the request-offer process in the existing round of negotiations. For this study the selected sectors are: construction; architectural, engineering and integrated engineering services; energy; and environmental services.

## 5.2 Pakistan's Horizontal Commitments in the Uruguay Round

Pakistan has made certain specific horizontal commitments on MA and NT relating to commercial presence (Mode 3) and movement of natural persons (Mode 4). These commitments are described below.

*Horizontal Commitments on Commercial Presence (Mode 3):*

Under Pakistan's horizontal commitment on MA, commercial presence (Mode 3) is allowed in all sectors but it is subject to "incorporation in Pakistan with maximum foreign equity participation of fifty one per cent [51 per cent] unless a different percentage is inscribed against a particular sector or sub-sector." [19] While foreign equity limitation does not apply to the representative offices of foreign companies operating in Pakistan, all expenses of representative offices are to be met by remittances from abroad. Under national treatment commitment, all real estate acquisition by non-Pakistani entities is subject to authorization depending upon the location and purpose of such acquisitions.

*Horizontal Commitments on Presence of Natural Persons (Mode 4):*

Under Pakistan's horizontal commitment on MA, presence of natural persons (Mode 4) is "unbound, except for measures concerning the entry or temporary stay of natural persons up to a maximum of fifty percent in superior categories (namely, Executives and Specialists) in an undertaking." [20]

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[19] See WTO document S/DCS/Pak dated 24 January 2003 at www.wto.org.

[20] By definition Executives are persons "who direct the management of the organization or establish goals and policies for the organization", and they are the one who "receive only general supervision or direction from higher level executives, or the Board of Directors." Similarly, the specialists are defined as those persons in an organization "who possess knowledge at an advanced level of expertise" and they "possess proprietary knowledge of the

## 5.3 Pakistan's Sector Specific Commitments in the Uruguay Round

Pakistan also made sector specific commitments in business services; financial services; communication services; health and related services; construction and related engineering services; and tourism and travel related services.[21] For the purposes of this study, Pakistan's scheduled limitations on MA and NT in business services, and construction and related engineering services are particularly relevant, which are discussed next.

*Business Services*:

In the business services, four sub-sectors that are scheduled with limitations are CPC 883+5115: Services incidental to mining, and site preparation work for mining; CPC 8672: Engineering services for building infrastructures: harbours, dams, hydal power, and airports, only; CPC 8673: Integrated engineering services; and CPC 8676: Technical testing and analysis services. In all these sectors, Pakistan did not make any MA or NT commitments regarding cross-border supply (Mode 1). Also for consumption abroad (Mode 2) no binding commitment was made in these sectors mostly for reasons of technical infeasibility, except CPC 8676 where Mode 2 (MA/NT) limitation was none.

In the Uruguay Round there are no market access or national treatment limitations on commercial presence (Mode 3) of foreign firms relating to CPC 883+5115: Services incidental to mining, and site preparation work for mining; and CPC 8676: Technical testing and analysis services. However, there are market access limitations on commerce presence in CPC 8672: Engineering services for building infrastructure, and CPC 8673: Integrated engineering services. These services are partially bound subject to limitations of "maximum of 40 per cent foreign shareholding in engineering consultancy companies; and subject to partnership and/or joint venture with Pakistani engineers or engineering companies." But there are no limitations to NT on commercial presence of foreign firms in the three sectors.

As far as presence of natural persons (Mode 4) in these sectors is concerned, these sub-sectors are unbound except as indicated under horizontal measures relating to movement of executives, consultants and specialists.

organization's products, service, research equipment, techniques and management." [WTO document S/DCS/Pak dated 24 January 2003 at www.wto.org]

[21] Pakistan has no Uruguay Round commitments relating to the energy and environment sectors because members did not negotiate them as separate sectors. Therefore, member country commitments in the energy sector were only subject to general obligations of the GATS rather than to market access and national treatment provisions. Similarly, in the environmental sector, Pakistan has no prior commitments or limitations on market access and national treatment, which by far remains unbound.

*Construction and Related Engineering Services*:

Pakistan made very little Uruguay Round commitments in construction and related engineering sectors. The only sub-sectors that are scheduled with commitments are CPC 5132: Construction work for civil engineering for bridges, elevated highways, tunnels and subways, and CPC 5133: Construction for civil engineering for waterways, harbours, dams and other waterworks. In these sub-sectors, while there are no market access or national treatment commitments for cross-border supply (Mode 1), and consumption abroad (Mode 2) for reasons of technical infeasibility, there are market access limitations. Market access limitations on commercial presence (Mode 3) in these sub-sectors is partially bound subject to the horizontal commitments relating to maximum equity participation of 51 per cent by foreign partnerships/ or joint ventures with Pakistani engineers or engineering firms. However, there are no national treatment limitations of Mode 3 in these sub-sectors.

## 6. THE REQUEST/OFFER PROCESS IN THE DOHA ROUND

### 6.1 Introduction

In the Doha Round negotiations, Pakistan has received requests from Members to liberalize services in every major sector. In return, Pakistan has submitted its initial offers in most of these sectors. Among others these requests/offers relate to construction and related engineering services; architectural, integrated engineering and engineering services; energy services; and environmental services.[22] Moreover, Pakistan has co-sponsored four requests seeking commitments from other Members. It should be stressed that as part of the negotiation process, all Members who co-sponsor a request to other members are considered to be recipients of that request as well. The key Members co-sponsoring requests to Pakistan in the selected sectors are European Communities (EC), Japan, US, Canada, Australia, Switzerland, the Republic of Korea, Norway, Malaysia, New Zealand, Mexico, Singapore, Turkey and Saudi Arabia. In this section, we summarize the request/offer process in the selected sectors in the on-going WTO negotiations on MA.

### 6.2 Requests Received by Pakistan in Selected Sectors

*Construction and Related Engineering Services*:

Pakistan has received a collective request sponsored by Japan to liberalize construction and related engineering services. The other requesting Members are Australia, Canada, Taiwan, Penghu, Kinmen and Matsu, the EC, Japan, the Republic of Korea, Malaysia, Mexico, New Zealand, Norway, Singapore, Turkey, and the United States of America. Apart from Pakistan, 18 other Members have also received this collective request in construction and related engineering services.[23]

This request highlights the importance of construction and related engineering services as representing fundamental activity in Pakistan that permeate all economic sectors and thus constitute single largest sector. Given the nature of construction services, it has critical importance for creating employment and economic growth. Because strong linkages exist between construction services and engineering, architectural and integrated engineering services, the overall affect of liberalization in construction services is expected to also depend on the extent of liberalization in engineering and integrated engineering services.

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[22] Other sectors covered in these requests are telecommunications; maritime transport; air transport; logistics; financial services; private education services; distribution services; Mode 3; and MFN exemptions in financial services.

[23] The members who have been requested to open their construction sectors are Argentina, Brazil, Chile, The People's Republic of China, Egypt, Hong Kong China, India, Indonesia, Israel, Kuwait, Malaysia, Nigeria, Pakistan, Peru, Qatar, The Philippines, South Africa, Thailand, United Arab Emirates.

The request substantially covers sub-sectors from CPC 511 to CPC 518. It specifically demands the elimination of any limitation (market access and national treatment) in Mode 1, Mode 2 and Mode 3. The request, however, does not cover movement of natural persons (Mode 4) limitations in the construction sector.

In terms of UN CPC classifications the request covers CPC 511: Pre-erection work at construction sites; CPC 512: Construction work for buildings; CPC 513: Construction work for civil engineering; CPC 514: Assembly and erection of pre-fabricated constructions; CPC 515: Special trade construction work; CPC 516 Installation work; CPC 517: Building completion and finishing work; CPC 518: Renting services related to equipment for construction or demolition of buildings or civil engineering works with operators.

More specific request of the Members relate to commercial presence (Mode 3) where MA limitations on foreign equity, restrictions on type of commercial presence (e.g., subsidiaries, branches and representative offices), and limitations of joint venture are of particular concern. Moreover, the request also deals with removal of some national treatment limitations pertaining to discriminatory registration and licensing procedures meant for foreign firms.

*Architectural, Engineering and Integrated Engineering Services*:

In the architectural, engineering and integrated engineering services, Pakistan has received a collective request to liberalize this sector. Sponsored by Canada the other requesting Members are Australia, Chile, the EC, Japan, Korea, Mexico, New Zealand, Norway, Switzerland, and the US. Twenty six other Members have also received this collective plurilateral request.

The coverage of this request and the sub-sectors are: CPC 8671: Architectural services; CPC 8672: Engineering services; and CPC 8673: Integrated engineering services. In Mode 4 the request is for commitment in all categories with a special emphasis on contract service suppliers. Finally there is a request for removal of limitations regarding economic needs tests (ENTs) (across all modes) and MFN exemptions.

*Energy Services:*

The collective request to Pakistan to liberalize energy services was sponsored by the EC with other interested Members: Australia, Canada, the European Communities, Japan, Norway, the Kingdom of Saudi Arabia, Republic of Korea, Taiwan, Penghu, Kinmen and Matsu, Singapore, the United States. This collective request on energy services has also been received by 22 other members of the WTO.

Because there is a need for member countries to provide varied energy sources at competitive prices for them to compete in the international market, and that there is a high correlation between efficient energy use and economic growth and development, therefore, the requesting Members underscore the need for liberalization of energy services in the ongoing negotiations. Moreover, the request treats energy services, firstly, as the means to develop energy resources in an environmentally sound manner and in ways that promote responsible and efficient development and use of energy resources. Secondly, the request is neutral with respect to energy source, technology, and whether offered onshore or offshore. Finally the request does not extend to the ownership of energy resources, which is outside the scope of GATS negotiation.

The services covered in the plurilateral request for energy services are CPC 8672-8673: Engineering and integrated engineering services; CPC 865-866: Management consulting services and services related to management consulting; CPC 8676 (partial): Technical testing and analysis services (excluding services related to medical devices, food and food products)), CPC 883: Services incidental to mining; CPC 8675 (partial): Related technical consulting services; CPC 8861-8866 (partial): Maintenance and repair of prefabricated metal products, machinery etc.; CPC 5134-5136: Construction work for civil engineering: for long distance pipelines, for local pipelines, for construction for mining; CPC 518: Renting services related to equipment for construction or demolition of buildings or civil engineering works with operator; CPC 62271: Wholesale trade in services of solid, liquid and gaseous fuels and related products (excluding electricity and town gas); CPC 66327: Retailing services of fuel oil, bottled gas, coal, and woods.

The requesting Members have asked Pakistan (along with other recipients of this request) to make commitments with widest possible coverage of sectors by scheduling new or improved commitments because these activities are closely integrated.

In the cross-border (Mode 1) supply of these services, the requesting members demand substantial reduction of MA limitations and removal of existing requirements of commercial presence. The commitment on consumption abroad (Mode 2) of energy services is requested where technically feasible. Because commercial presence (Mode 3) is an essential mode of supply for most energy services, the request is made for removal of foreign equity limitations; elimination of joint venture/joint operation requirements for foreign service providers; removal of economic needs tests; and discriminatory licensing procedures in the energy services. Finally, the request is also made for horizontal commitments for movement of natural persons in the energy sector (Mode 4) to which the United States is not a requesting member, but is considered as a recipient.

*Environmental Services*:

Pakistan has received request to liberalize environmental services from the following Members: Australia, Canada, EC, Japan, Korea, Norway, Switzerland, Taiwan, Penghu, Kinmen and the US. Sponsored by the EC, this collected request on environmental services has been received by 23 Members including Pakistan. This request does not cover water for human use (i.e., collection, purification and distribution of natural water).

The WTO Services Sector Classification (WTO Document W/120) defined environmental services into four sub-sectors of activity: 6.A Sewage services; 6.B Refuse-disposal services; 6.C Sanitation and similar services; and 6.D Other Environmental Services. However, the provisional UN CPC 94 classification includes several new classifications for environmental services not currently listed in W/120. The Members have requested that Pakistan undertake commitments in all environmental services sub-sectors by using provisional CPC classifications.

The activities covered in the request include: CPC 9401 Sewage services; CPC 9402: Refuse disposal services; CPC 9403: Sanitation and similar services; CPC 9404: Cleaning services of exhaust gases; CPC 9405: Noise abatement services; CPC 9406: Nature and landscape protection services; and CPC 9409: Other environmental services not elsewhere classified.

Cross-border (Mode 1) movement of environmental services has remained unbound in the past due to lack of technical infeasibility. There is growing evidence that environmental services can take place remotely from a second country, e.g., wastewater treatment plants, and pollution levels). Therefore, the Members request Pakistan (along with other recipients) to schedule Mode 1 commitments in environmental services as much as possible as "none." The Members also request Pakistan to make full commitment for all sectors on consumption abroad (Mode 2).

Since commercial presence (Mode 3) is a predominant mode of supply of environmental services, the request is made for removal of barriers to commercial presence including foreign equity limitations; joint operation requirements; types of legal entity for foreigners such as joint ventures. The supply of environmental services in Pakistan is largely subject to public monopoly and exclusive rights. For instance, federal, provincial, local, *tehsil* governments control most of the environmental services in a highly protected environment. The requesting members seek that to the extent that Pakistan "awards exclusive rights to environmental service suppliers, foreign service suppliers should be able to participate in the supply of the services."

Finally, the request is also made for horizontal commitments for movement of natural persons (Mode 4) in the environmental services either under sector heading or under the horizontal commitments to which the United States is not a requesting member, but is considered as a recipient.

### 6.3 Requests Made by Pakistan

Pakistan has also co-sponsored four plurilateral requests seeking commitments from other Members to liberalize trade in computer and related services; movement of natural persons; cross-border supply; and MFN exemptions. Being a co-sponsor, Pakistan is also deemed to be a recipient of these requests. Here we summarize Pakistan's request in movement of natural persons, and cross-border supply.

*Movement of Natural Persons (Mode 4)*:

Sponsored by India, this request seeks Members to make commitments in providing effective market access on movement of natural persons (Mode 4).[24] This request is addressed to nine developed Members namely, United States, EC, Australia, Canada, Japan, New Zealand, Switzerland, Norway and Iceland. The requesting members belong to developing countries and consist of the following: Argentina, Brazil, Chile, China, Colombia, Dominican Republic, Egypt, Guatemala, India, Mexico, Morocco, Pakistan, Peru, Thailand, Uruguay.

The request highlights that the existing commitments in Mode 4 by Members are predominantly horizontal where not only the coverage is narrow but also restricted to personnel movement in relation to commercial presence (Mode 3). It is also noted that when de-linked from commercial

[24] See WTO document TN/S/W/31 at www.wto.org

presence, the coverage of the categories in Mode 4 is extremely low. Therefore, the request urges the recipients to make commitments by recognizing "common categories of movement both linked to as well as de-linked from commercial presence in the horizontal commitments to Members."

The request defines five common categories of interest in which the Members can link MA in Mode 4 namely, intra-corporate transferees; business visitors; contractual service suppliers – employees of juridical person; independent professionals; and other categories.

The request lists the market access and national treatment limitations for each of the defined category to which the Members have been asked to schedule removal commitments. More specifically, the Members have been asked to address specific MA conditions such as qualifications, period of employment, duration of stay, removal of economic needs tests and transparency in such tests, and removal of wage parity, etc.

*Cross-Border Supply (Mode 1 and Mode 2)*:

This request is also coordinated by India and seeks liberalization commitments in cross-border supply of services in Mode 1 and Mode 2 from twenty one WTO Members namely, United States, EC, Canada, Japan, Korea, China, Malaysia, Philippines, Indonesia, Brazil, Argentina, Egypt, South Africa, Peru, Colombia, Uruguay, Brunei Darussalam, United Arab Emirates, Australia, Norway and Thailand. The request has been put forward by Chile, Hong Kong China, India, Mexico, New Zealand, Pakistan, Switzerland, Singapore, Taiwan, Penghu, Kinmen and Matsu. The requesting members are also deemed to be recipients of this request.

Technological innovations in IT not only have extended the range of services that can now be traded internationally, but also have increased the importance of cross border supply in a wide array of service sectors. Whether or not there are actual restrictions on the ground for cross border supply of services, the fact remains that gaps in current commitments of Members exist, which need to be plugged for better MA opportunities.

The request seeks Members to make full market access and national treatment (new/improved) commitments in Mode 1 and Mode 2 in sectors/sub-sectors of interest where gaps in commitments do exist in Members' schedules (a list of such sectors/sub-sectors is also circulated with the request).[25] The request identifies the need for flexibility for individual developing country members under Article VIX:2 of the GATS.

Due to uncertainty in classification of certain services delivered electronically as either Mode 1 or Mode 2, the Members are requested to make similar commitments for both Modes of supply. However, in situations where the two types of service supply can be differentiated, different commitments are warranted in Mode 1 and Mode 2.

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[25] List of sectors/sub-sectors where specific commitments in Modes 1 and 2 are sought broadly cover professional services; computer and related services (at two-digit level); real estate services; rental/leasing services without operators; other business services; telecommunication services; distributional services; environmental services; financial services; all insurance and insurance-related services; banking and other financial services; tourism and travel related services; recreational, cultural and sporting services; and services auxiliary to all modes of transport.

## 6.4 Initial Offers Made by Pakistan

Pakistan submitted its conditional initial offer to the WTO Council for Trade in Services on 24 May 2005. The initial offer not only revises Pakistan's horizontal and sector-specific commitments made in the Uruguay Round, but also comprises of a range of new sectors and sub-sectors with new and improved commitments. In the initial offer, Pakistan has signalled its intention of liberalizing fully by scheduling commitments in all modes of supply including Modes 1 and 2 in which Pakistan had not scheduled commitments at the end of the Uruguay Round.

*Revised Horizontal Commitments*:

Pakistan has revised its horizontal commitments on MA in the initial offer under Mode 3 whereby the maximum foreign equity participation has been increased from 51 per cent to 60 per cent for all sectors included in its Schedule unless otherwise specified against a particular sector. The national treatment clause pertaining to restrictions on acquisition of real estate by non-Pakistani entities has also been removed in the initial offer.

The initial offer has also revised Mode 4 commitments by re-defining categories for intra-corporate transferees, business visitors, professionals, independent professionals and other skills in order to facilitate the temporary entry of service suppliers. To facilitate temporary visit and stay of these natural persons, periods of stay for each category have also been defined.

*Construction and Related Engineering Services*:

Pakistan did not make any change in its initial, offer over and above its Uruguay Round commitment, toward CPC 5115: Site preparation work for mining. However, Pakistan signalled its liberalization commitments toward this sector by easing market access and national treatment limitations in its initial offer toward CPC 5132: Construction work for bridges, elevated highways, tunnels and subways; and CPC 5133: Construction work for waterways, harbours, dams and other water works. While Mode 1 and Mode 2 were unbound in the Uruguay Round commitments due to lack of technical feasibility toward these sub-sectors, these restrictions have been removed in the initial offer. Similarly, as part of horizontal commitments in Mode 3, equity limit has been raised from 51 per cent to 60 per cent, which is subject to the limitation of partnership/joint ventures with Pakistani engineers or engineering companies. There are no further Mode 4 commitments in the initial offer except re-definition of categories of natural persons as part of horizontal commitments.

There is no existing government policy in several other CPS classifications in which Pakistan has received request for liberalization in the Doha Round viz., CPC 511: Pre erection work at construction sites; CPC 512: Construction work for buildings; CPC 513: Construction work for civil engineering; CPC 515: Special trade construction work; CPC 516: Installation work; CPC 517: Building completion and finishing work; and CPC 518: Renting services related to equipment for construction or demolition of buildings or civil engineering works with operator.

It is generally viewed by the government that openness and therefore competition in these sub-sectors may improve the standard of construction and lower the cost of construction work.

*Architecture, Engineering and Integrated Engineering Services (clubbed together as one request)*

Pakistan has made new commitment in its initial offer toward CPC 8671: Architectural services by removing restrictions in Mode 2 and by setting limit on foreign firms' maximum equity of 51 per cent, subject to a) participation of local partners, b) economic needs tests based on inquiry that no government subsidy is being provided, and c) fulfilment of requirements and conditions applicable to foreign investors/juridical entities. Pakistan's Mode 4 commitments in this regard are unbound, except as indicated in the horizontal commitments.

Moreover, there was also a change in policy in the initial offer on Pakistan's commitment in Mode 2 and Mode 3 under the limitation on market access and national treatment on CPC 8672: Engineering services for building infrastructures; and CPC 8673: Integrated engineering services. The commitment on Mode 2 for both the sub-sectors was changed from unbound to none. In Mode 3, the percentage of foreign shareholding was relaxed to a maximum of 51 per cent from the initial 40 per cent in both categories, subject to partnerships/joint ventures with Pakistani engineers or engineering companies. Moreover, in CPC 8673, the foreign firms were exempted from maximum equity and local partnership limitations if these were registered with the Securities and Exchange Commission of Pakistan (SECP). Mode 4 was unbound except as was indicated under the revised horizontal measures.

*Energy Services*:

Some of the requests in the energy services overlap with those for construction services and architecture, integrated engineering and engineering services. The first such overlapping request relate to CPC 8672 – 8673: Engineering and Integrated Engineering Services on which Pakistan's initial offer has already been discussed above.

Pakistan has yet to make a commitment on CPC 865 – 866: Management consulting services and services related to management consulting. This sector is also part of the EC's bilateral requests on which Pakistan may want to come up with a policy. The other sub-sectors on which Pakistan has yet to make a commitment are: CPC 8675 (partial): Related technical consulting services; CPC 8861-8866 (partial): Maintenance and repair of prefab metal products, machinery etc.; CPC 5134-5136: Construction work for civil engineering: for long distance pipelines, for local pipelines, for construction for mining; CPC 518: Renting services related to equipment for construction or demolition of buildings or civil engineering works with operator.

Pakistan has improved its commitment in its initial offer for the category CPC 8676 (partial): Technical testing and analysis services (excluding services related to medical devices, food and food products). The only change in this category from its Uruguay Round commitment was in Mode 1 where from an unbound commitment in both MA/NT, Pakistan has moved to 'none' or no limitation.

No improvement was made in the initial offer of Pakistan toward CPC 883 + 5115): Services incidental to mining and site preparation. While there are no MA/NT limitations on Mode 3, Pakistan may want to consider liberalization of these services through Mode 1 and Mode 2.

There was no Uruguay Round commitment toward CPC 62271: Wholesale trade in services of solid, liquid and gaseous fuels and related products (excluding electricity and town gas); and CPC 66327: Retailing services of fuel oil, bottled gas, coal, and woods. Pakistan has made some new commitments toward these sub-sectors in its initial offer. Under limitation on MA/NT, Mode 1 is unbound while there is no limitation in Mode 2. In Mode 3 there are two conditions attached. The first condition is that MA would be allowed subject to Economic Needs Testing (ENT), which includes need assessment of proposed locality being catered to by the supplier, and the second condition sets foreign equity limit at 51 per cent. Mode 4 is unbound except as indicated under the new horizontal commitments.

*Environmental Services:*

Pakistan made an initial offer of commitments regarding liberalization of environmental services. The offer focused on CPC 9402: Refuse disposal; and CPC 9403: Sanitation and similar services. It was, however, explicitly stated by Pakistan that their offer does not include, public works functions owned and operated by federal, provincial, district, *tehsil* level government or municipalities or contracted out by them.

Market access in cross border supply (Mode 1) and consumption abroad (Mode 2) is unbound, that is, there is no previous or current policy commitment. Market access pertaining to presence of natural persons (Mode 4) is also unbound except as indicated in the horizontal commitments. However MA in commercial presence (Mode 3) is allowed when two conditions hold, a) foreign equity is not to exceed 51 per cent, and b) Economic Needs Testing of a foreign firm would be based on inquiry to gauge if direct or indirect government subsidy was being provided. With regard to Mode 4 commitments, Pakistan has already put forward categories of persons with appropriate time periods of stay in its horizontal section in its initial offer.

Currently there is no policy on CPC 9404: cleaning services of exhaust gases; CPC 9405: Noise abatement services; CPC 9406: Nature and landscape protection services; and CPC 9409: Other environmental services not elsewhere classified.

## 7. PAKISTAN'S CONSULTATIVE MECHANISM ON SERVICES TRADE

### 7.1 Overview

Dialogue between the government and various stakeholders is crucial in building capacity in a country to effectively participate in multilateral trade negotiations on market access and national treatment of foreign service-suppliers. Countries where effective consultative mechanisms are in-place for making national decisions on trade issues are well prepared to accurately identify the challenges and risks of opening up of the economies to foreign competition. Presence of an effective policy consultation mechanism, involving the key stakeholders, improves the capacity of a country, not only, to effectively negotiate, but also, to implement trade policy reforms leading to its enhanced competitiveness in the global arena.

Although, Pakistan has made significant progress in recent times in formulating well-defined Rules of Business of the GoP to prepare Annual Trade Policy, and to regulate and legislate trade in services through respective line ministries dealing with these activities. A similar well-defined consultative mechanism on bilateral and multilateral services trade negotiations is not yet present that could help negotiators take concrete positions on key liberalization and restructuring issues being debated. In effect, the negotiators and policy makers are seriously constrained to identify the market impacts of a policy change. In what follows, we present a critique of the present consultative mechanism and highlight some of the impediments that make it complex for the stakeholders in the public and the private domains to effectively contribute in the dialogue aimed at formulating effective negotiating strategies on services trade issues being debated at the WTO.

### 7.2 Consultative Mechanism on Annual Trade Policy

The trade policy consultation mechanism in Pakistan weakly resembles a bottoms-up system because it recognizes formal inter-ministerial consultations with relevant ministries and specialized government ministries, chambers of commerce and industry, business and manufacturers' associations, missions abroad, provinces and international donors. However, civil society organizations, labour unions and academic institutions are not consulted during the trade policy cycle.

For preparing annual trade policy, Pakistan has evolved an elaborate consultation mechanism for decision-making. However, other than the government machinery, the process is limited to trade bodies, producer groups, exporters and international donors [ITC (2006), Saeed et al. (2005).[26]

[26] The Trade Policy is announced by the Federal Commerce Minister every year in the month of June or July. The formulation of the trade policy involves extensive consultations within the Ministry of Commerce, inter-ministerial consultations, consultation with specialized government agencies, provincial governments, representatives of the Federation and its constituent Chambers of Commerce & Industry, trade & industry associations, exporters in all sectors, donors & international agencies, and academia & research organizations. Written proposals are also sought from these stakeholders by the . The Chambers of Commerce and Industry formulate proposals through their sub-committees by holding sector-wise meetings while donors and international agencies give their recommendations

The political economy of the trade policy suggests that some groups benefit from policy change while others are hurt. Therefore, effective trade policy needs expert advice to gauge the market impacts of these policy changes on the interrelated interests of capital vs. labour, producers vs. consumers, and big vs. small business to name a few. How the interests of labour, consumer groups and small business are watched in this otherwise elaborate consultative mechanism is a mute question.

There is the further concern that the MoC does not have a permanent structure or even the human capital present to formulate policies or to analyze the merit of the opinions and proposals coming from various stakeholders. Due to lack of adequate research and development facilities, the MoC is not well-equipped to assess Pakistan's sector-wise competitiveness vis-à-vis its major competitors. For the same reason, professional lobbies that have the capacity, knowledge and the insights to take firm positions are more likely to prevail upon the MoC, which at times may lead to distortions across industries producing sub-optimal results for the economy.

### 7.3 Consultative Mechanism on Trade in Services

Turning to the consultation mechanism for policy on services trade while a limited number of private sector entities are consulted formally or informally in formulating day to day policies impacting services trade in the country, ironically most non-state stakeholders are left out of the loop while negotiating bilateral and multilateral agreements, which are likely to have long-term implications on the economy. Part of the reason is that although, well defined Rules of Business of the GoP exist for the purposes of legislation in trade in services, these rules are yet to be framed to define a formal consultation mechanism for bilateral and multilateral negotiations.

To illustrate, there is a complex inter-ministerial consultation process stipulated by the GoP to formulate policies on services trade. For example, there are twenty-eight divisions/ministries, several federal agencies and provincial departments that are directly or indirectly associated with services trade activities in the country [Saeed et al. (2005, ITC (2006)]. Similarly, there are about 50 registered chambers of commerce and industry, a Federation of Pakistan Chambers of Commerce and Industry (FPCCI) and more than 200 registered (with FPCCI) and non-registered industry associations, many of which are responsible for trade in services activities in the country [Saeed et al. (2005)]. While the Information Technology and Telecommunications Division is formally mandated by the government to coordinate with the private sector, the other Divisions involved in regulating other services do not have a formal mandate to coordinate with the private sector. However, informal consultations are often made with elite representatives of peak national organizations on an ad hoc basis, or as and when such an input is needed by the government.

based on their research studies. These proposals are then discussed in a big stakeholder meeting held in April. Subsequently, a draft trade policy is formulated internally after giving consideration to the stakeholder view points. Trade policy is finalized in an internal trade policy workshop, which is also attended by SBP and the Central Board of Revenue (CBR). The final document is then taken to the Prime Minister and the Federal Cabinet for approval before its announcement by the Commerce Minister.

Consultations are also made with the members of the Parliament through such bodies as the WTO Council (consisting of Ministers of related ministries), the WTO Taskforce (consisting of the members of the national assembly including the Commerce Minister), and Standing Committees of the National Assembly and the Senate (oversight committees) [Saeed et al. (2005)]. But, due to highly technical nature of the services trade issues and lack of capacity, these Parliamentary bodies only play an oversight role without having much to contribute in policy formulation, legislation or in devising negotiating strategies for the services trade.

In this 'tops-down' strategy, the government maintains a firm control on legislation and policy formulation at the top level of the government. A 'tops-down' policy, as ITC (2005) points out, "may reduce the opportunity for rent-seeking by private interests by offering limited private sector access … and it may be more efficient because it reduces the opportunity for disruptive debates about policy directions." However, with such a tight grip on policy the government is often constrained to identify the market impacts of a policy change and the capacity of the country to effectively negotiate further trade policy reforms in bilateral and multilateral negotiations.

## 7.4 Constraints in the Negotiating Process and the Way Forward

Lack of understanding and foresight on services trade issues within both the public and the private sectors is a major constraint for Pakistan to effectively participate in trade negotiations at the WTO. There are more than three dozen line ministries, divisions and government departments dealing with the policy making and legislation about the services sector. The research and development facilities and procedures at the MoC and other relevant ministries and divisions are extremely inadequate and below par. Due to a heavy bilateral trade agenda and expanding negotiations for free trade areas with trading partners, the government machinery seems increasingly under-resourced to cope with the full range of these issues. The bureaucracy is ill equipped and therefore lacks relevant expertise to handle highly technical trade related issues. Therefore, the MoC urgently needs to enhance its in-house capacity to conduct sub-sector assessments by strengthening its research units and the team of legal experts so that they could provide timely support to the Geneva based negotiators.

A major constraint for the private sector and their professional groupings is the limited institutional capacity and knowledge to evaluate the implications of the proposals being negotiated. Even though organizations such as the FPCCI can play an active role in putting forward the viewpoint of the service industries, they also need to enhance the capacity of their research department before they are able to meaningfully contribute in the negotiation strategies. At the same time, several service sector grouping are not even registered with the FPCCI to be counted. Some of them even do not have representative professional groups that could enable all their members to be satisfied. How such groups could be brought on-board in national consultative mechanism while remains a rallying cry, but also makes it difficult for the policy makers to identify true market impacts of a policy change in those sub-sectors.

Another constraint toward creating such a capacity relates to the availability and quality of data on services trade. Non-availability of reliable data on most service sectors has been a major constraint for pursuing a meaningful research agenda. The published statistics on services trade is deficient because Pakistan does not collect data under four modes of supply of the GATS. This problem is further augmented due to deficiencies relating to the obsolete classification system and highly aggregated nature with which the data is collected. Except for the banking and energy services where high quality data is often available, non-availability of reliable data in most other service sectors has been a major constraint for pursuing a meaningful research agenda either by the government or the private sector.

It should be emphasized that a policy that is aimed at minimizing costs and maximizing gains from services trade liberalization should be broadly inclusive and transparent. A consultation strategy that is broadly representative should not only include all levels of government, but should also include formal representation of business groups, labour groups, civil society organizations and the academia. While the inter-ministerial consultation process in Pakistan may be strong, the representative character of the other groups is quite bleak.

If the civil society organizations and academic institutions are involved in the consultative process, they are more likely to effectively fill the void created due to weak institutional capacities of the public and the private sector organizations. For instance, some civil society organizations have lately been very active in raising awareness through media campaigns on several trade related issues. Some of them also have their research and analysis departments on the WTO. Similarly, while no consultative role has been assigned to independent academic institutions and think tanks, they have the capacity and resources to undertake careful analysis of the alternative trade strategies. In this regard, the neighbouring countries of India and Bangladesh have made considerable progress toward involving academic institutions and think-tanks in the negotiation process.[27] Proposals for government-academia collaboration on research on trade related issues have frequently been discussed between the MoC and few leading private academic institutions in Pakistan, yet no break through could be made in this direction. Even if such initiatives do bear fruit in the near future, the paucity of services trade data due to the above mentioned constrained would pose a serious challenge.

## 7.5 Conclusion

All in all, Pakistan still needs to set up institutional foundations that could help them formulate effective trade negotiating strategies on bilateral and multilateral fronts to maximize the gains and minimize the risks of exploitation by their negotiating partners. The analysis suggests that the presence of a formal mechanism which is 'bottoms-up' rather than 'tops-down' to hold consultations with national stakeholders is direly needed. While Pakistan has recently evolved an elaborate mechanism to involve private sector and civil society actors in formulating annual trade policy and legislation in trade in services, the consultative mechanism for negotiating bilateral and multilateral agreements on trade in services is more inward looking. Most national

[27] India has recently involved the National Council for Applied Economic Research (NCAER), the Indian Institute of Foreign Trade (IIFT), the Indian Council for Research on International Economic Relations (ICRIER) and the RIS in the consultation process [ITC (2005)]. Similarly, Bangladesh has set up advisory committee in the Ministry of Commerce to consult all the stakeholders including private sector, academia, civil society and related ministries through constitution of five working groups on separate topical issues including trade in services.

stakeholders are left out of the loop, except the state actors, on important issues on services trade under negotiation at the WTO. The Ministry of Commerce (MoC), WTO Wing is mainly responsible for trade negotiations through Pakistan's Geneva Mission. However, given the ever expanding bilateral and multilateral trade related issues, the in-house capacity of the Ministry to deal with highly complex issues, especially to conduct thorough sub-sector specific assessments is a major constraint. The government has yet to define a formal consultation process for services trade negotiations like the one present for annual trade policy for bilateral and multilateral services trade negotiations where non-state actors such as private sector, academic and civil society are also involved. In the absence of such a mechanism the top government officials are holding the major responsibility of taking positions in services trade negotiations. Not only that a tight grip on services trade negotiation constrains the ability of the government to identify the market impacts of a policy change, but also hinders the capacity to effectively negotiate further trade policy reforms in bilateral and multilateral negotiations. The analysis in the remaining sections identifies the nature and extent to which official and private positions may differ in the absence of a "bottoms-up" mechanism to hold consultations with national stakeholders.

# 8. STAKEHOLDERS’ FEEDBACK ON PAKISTAN’S REQUEST/OFFER

## 8.1. Introduction

Theoretically, the views of the national stakeholders on Pakistan’s request/offer should play a critical part in the positioning of Pakistan’s stand in the multilateral negotiations in the Doha Round. By contrast, the feedback obtained from the stakeholders tells a different story on the nature of their involvement and capacity to understand the complex set of services trade issues. To get feedback on Pakistan’s request/offer in the Doha Round of negotiation, we conducted detailed interviews with stakeholders from the government including the regulators, the private sector, professional trade groups, civil society organizations, academia and the think-tanks. In this section we outline the views of the stakeholders regarding the liberalization policy and the request/offer of Pakistan in the selected service sectors.

The views of the stake holders in respective sectors is provided in the specific back drop of the existing policies of the GoP relating to liberalization in that sector and the requests for further openness put forward plurilateraly by groups of countries to the GoP. In order to capture the various facets of liberalization and its perceived impact, the views of the stakeholders roughly cover the following key areas: a) Involvement of the stakeholder in the policy making framework; b) opportunities for regional trade in the service; c) assessment of the currently existing regulatory framework, d) impact of liberalization reforms, and e) views on further liberalization in the context of the specific plurilateral requests received.

The stakeholders in each of the service sector have been broadly divided into three categories. The first is the government or public sector engaged directly or indirectly in the provision of a particular service. The second is the regulatory body, if any, instituted by the government in the wake of privatization and liberalization within the sector. The final category is the private sector, which includes both the non-governmental bodies and associations linked with the particular service and the private corporation engaged in the provision of the service.

## 8.2. The Stakeholders’ View

In the first part we analyze the opinions of stakeholders within the construction; architectural, engineering and integrated engineering services; and energy services. The reason behind clubbing together these sectors is the commonality of sub-sectors for which the plurilateral requests have been put forward. In the second part, we elaborate the views of key players within the environmental service sector.

*Views on Construction and Related Engineering, Architecture, Integrated Engineering and Energy Services*

i) The Public Sector

The following are the views of the representatives of a large semi-autonomous public sector firm in Pakistan which offers consultancy services in construction and related engineering, architecture, engineering, related engineering and energy services. The firm was established with the primary objective of achieving self sufficiency in these sectors and therefore to reduce the high levels of dependency on foreign service providers. A secondary objective was to provide services to the government in projects which were considered to be classified. The firm enjoys a monopoly share in the government projects. Its presence in private sector is relatively low except for construction supervision where it is engaged by large private sector consultants.

Today the firm has a significant share of the domestic market and also exports its services to 34 different countries. Almost 30 per cent of its revenues are generated from the export of services.[28] However, the countries to which these exports are directed are all part of the developing world. According to the firm, the main hindrance in service provision in the developed world (US and EC) is faced in Mode 3 (commercial presence) and Mode 4 (movement of natural persons). These barriers to entry range from the rejection of education qualification of Pakistani engineers/consultants, paucity of financial resources to lack of credibility required to successfully bid for contracts in the developed world.

Although this semi-public firm is not directly involved in the policy making framework, it does provide input to government's queries whenever these arise. Consultations also take place at various meetings organized by the government or its relevant ministries.

PEC is the statutory regulator for construction and engineering sectors in Pakistan.[29] PEC revised its rules and regulations in 2003 in accordance with the WTO guidelines. Presently, all firms (both construction and engineering) must be licensed by PEC to operate in the country. It was stated by a representative of this semi-public firm that the rules require foreign companies in the construction sector to enter into a joint venture with a local firm before the bidding process i.e., foreign firms in the construction sector can own up to 70 per cent of the venture, thus, at least 30 per cent is the share of the local firm. It was also claimed that foreign firms are exempted from entering into a joint venture if these agree to transfer technology during the duration of the project in Pakistan. It was further pointed out that PEC had no conditions on profit repatriations, such conditions were said to come from other ministries or divisions of the Federal Government.[30]

Regarding the engineering sector it was stated that the schedule of commitments in the WTO state that foreign firms can own up to 40 per cent of the joint venture projects. According to this firm, the PEC had no such condition imposed on the foreign firms. However it was claimed that the percentage of profit repatriation is based on the non-availability of certain technical capacities within the country.[31]

[28] The firm claims to have a comparative advantage in the construction of roads, small commercial buildings and small bridges.

[29] The Pakistan Engineering Council came into existence by an Act of Parliament of Pakistan in 1976. The PEC through a set of Bye-laws regulates the engineering sector (engineering consultancies and engineering /construction services) and provides accreditation to engineering universities in the country.

[30] According to a Member of the Governing Body of the PEC the joint venture clause and the equity requirement introduced by the has nothing to do with the PEC Bye-laws. However it was indicated that there is a three member committee to deal with such issues. The members were the PEC, the Ministry of Works and the client.

[31] In the initial offers, May 2005, under limitation on market access the only change in policy since the Uruguay Round on CPC 8672 (engineering) and 8673 (integrated engineering) was in Mode 3. The percentage of foreign

The overall opinion of this public sector firm regarding liberalization was very clear. Complete liberalization was considered to be against the central objective of self sufficiency under which the firm was established. It was opined that Pakistan could potentially benefit from liberalization if more sub-sectors within construction and related engineering services were opened up to foreign investors under the existing conditions of joint ownership and transfer of technology. Further relaxation of conditions in any of the sub-sectors was not recommended by this important player. Thus the suggestion was to widen the scope of conditional liberalization across different sub-sectors rather than deepening the extent of it within a particular sector.

ii) The Private Sector

According to most of the players in the private sector, the over arching problem common to the construction and related engineering, architecture and engineering sector was the outdated technology in operation within the country. This was manifested, especially in the construction sector, by a lack of knowledge of modern techniques and methods and lack of mechanization of operations.[32] Moreover, particularly in the construction sector, the following areas were also indicated as weak and thus in need for an immediate redress: a) organizational structure; b) quality of engineers; and c) financial weakness.

The private stake holders expressed an urgent need to improve and revamp the functional capacity of the sector (construction, architecture and engineering). This improvement, according to the players, could be successfully brought about through better training institutions that would produce quality engineers and draftsmen. Therefore, it was the opinion of almost all the private stakeholders that Pakistan needs to invest in both engineering education and in vocational training institutes in order to compete internationally and locally with foreign companies.

It was also pointed out that there was an absence of a proper consultative process or mechanism through which the private sector could put forward its views to the GoP relating to future policy formulation and feedback on existing policies. Some of the larger stake holders indicated that they were regularly invited to relevant ministerial meetings, however, the general appreciation of these players was that even when the GoP accepts policy advice from the private sector during such meetings it consistently fails to take any concrete actions based on the recommendations it receives. Even though within the construction sector there are representative bodies these play a minimal role in policy making. For example, the All Pakistan Contractors Association (APCA), a representative body of small and medium scale construction contractors, plays a fairly prominent

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shareholding was relaxed to a maximum of 51 per cent in both categories. Moreover, in CPC 8673, the foreign firms were exempted from both the two conditions if these were registered with the Securities and Exchange Commission of Pakistan (SECP).

32 Liberalization in CPC 518 (Renting services related to equipment for construction or demolition of buildings or civil engineering works with operator) would relieve this major constraint in the construction sector. The representative of the PEC interviewed was also in favor of liberalization in renting services equipment with some regulatory provisions however.

role in the Lahore Chamber of Commerce and Industry but the association has never been consulted by the government in the policy making process.[33]

In reference to existing foreign competition it was indicated that the construction and engineering sectors are financially weak rendering the relatively smaller player more vulnerable to foreign competition.[34] As a result of financial and capacity limitations an average Pakistani company cannot bid for the pre-qualification of any major government project which inevitably is taken up by foreign companies. It was stressed however that the services of these foreign companies are generally limited to design and architectural consultancy while construction work is outsourced to local companies. In the opinion of the largest private sector engineering consultancy firm in the country, liberalization in the sector would not harm their interests or those of larger players but would have an adverse impact on the smaller contractor in the construction sector.

It was also indicated by the private sector that there was considerable potential of foreign investment in real estate development within Pakistan – as this sector in recent years has experienced unprecedented levels of growth. It was pointed out that the main reason why this has not materialized is primarily because of the risks involved in buying land in Pakistan. It was suggested that the government should form a Land Bank to facilitate foreign investment in this area. It was claimed that this would reduce the risks involved in land acquisition for the specific purpose of real estate development in the country.

Within the real estate sector, it was further claimed, that Pakistan could be a significant market for low-cost housing solutions. Pakistani companies do not have the necessary expertise for developing low cost housing. Therefore, foreign investment was regarded as essential to ‘kick start’ this sub-sector.

Regarding the existing regulations or conditions on foreign companies it was stated by some of the players in the private sector that the current PEC regulations require Pakistani companies to have at least 30 per cent share if these enter into a joint venture with a foreign company. However, it was stressed, that foreign companies do not follow this in letter and spirit and only enter into a joint venture purely “on paper”.

On the existing policy and the impact of further liberalization within these sectors it was held by some of the stakeholders that it was not just the degree or extent of liberalization that was stopping foreign companies from investing in Pakistan. In fact the source of the hindrance were the type of concessions these foreign firms were demanding, i.e., waiver of visa restrictions for their workers, removal of restrictions on moving equipment in and out of the country, no requirement of either a joint venture with a local company or local registrations. [35]

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[33] The representative of the PEC interviewed was also of the opinion that the Ministry of Commerce needs to set up sub-committees on the construction sector for consultation with the relevant stakeholders. The Ministry of Commerce, it was stated, does not always involve the PEC for policy formulation purposes.

[34] The smaller players in the construction industry as a policy do not enjoy credit financing facilities severely limiting their scale of operation and future growth prospects.

[35] These concessions are in fact part and parcel of what constitutes greater liberalization.

Finally there was a consensus on the benefits of further liberalizing regional trade within these sectors. Trade with India in these services was highlighted not just as a source of appropriate indigenous technology but also of potential engineers – a resource, which according to almost all the players, Pakistan seriously lacked.

*Views on Environmental Services*

i) The Regulator

The domain of the Pakistan Environmental Protection Authority (the environmental regulator) covers relevant areas in health, sanitation and population sectors. It also includes insuring imports of environmentally friendly industrial inputs, regulate and oversee the treatment of waste and enhance or promote bio-diversity. The view of this important stakeholder pertaining to Pakistan's existing and future policy vis-à-vis liberalization in the sector is summarized below.

According to the regulator a complete or unbound liberalization of the environment sector could have adverse effects on Pakistan's economy simply due to the very 'sensitive' nature of the sector. It was maintained that MA to foreign firms/consultants in the field of environment might open a 'Pandora's Box', that is, it could expose the extent of industrial pollution in the country which if publicized by the media would not be in the economic interest of the country. The regulator gave the example of the textile sector which was sighted as the major contributor to industrial pollution.

The regulator was of the view that although National Environmental Quality Standards (NEQS) are in place, their strict implementation would harm the industry in Pakistan, in particular, the small and medium enterprise sector. This sector due to financial constraints would be unable to adopt the cost intensive environment friendly technology. In this context the regulator stressed the potential benefits of liberalizing regional trade, especially with India, which apparently has made headway in indigenous and cost effective environment friendly technology for small and medium scale enterprises.

Although the regulator was opposed to an across the board liberalization in the sector it was however indicated that there were some sub-sectors where conditional liberalization would be beneficial. These were, waste water treatment[36], emission cleaning technologies and sewerage and waste disposal services.[37]

Recycling of organic waste was sighted as a key area where foreign investment could be profitable and worthwhile for the country. In particular, the scope of establishing waste recycling plants such as compost (organic fertilizer) plants in various parts of the country was highlighted.

The regulator was of the view that due to increasing urbanization the sewerage and waste disposal services in the major cities of the country had virtually collapsed. It was pointed out that the city district governments were a key stakeholder in this sub-sector. Lack of resources

[36] The plurilateral requests received however state the non-inclusion of services related to water for human use, that is, collection, purification and distribution of natural water.
[37] These services categorized as CPC 9402, 9403, and 9404, are included in the plurilateral requests.

compounded with inherent administrative and operational inefficiencies was the central reason behind the failure of the government in this area. Given these serious resource and capacity constraints the solution was the involvement of the private sector. However due to their own vested interests, the local municipal authorities under the city district government were opposed to the entry of the private sector (domestic or foreign firms) in services such as refuse collection.[38]

According to the regulator this opposition from the government service provider was not the only obstacle towards privatization or liberalization. The extent and quality of the service provided by domestic firms were also constrained because of a lack of specialized equipment required for waste disposal.[39] The regulator warned that if they (the private sector) invest in these technologies the cost of the service provision to the public could greatly increase thus reducing the public ability to access the service.[40]

The regulator further stated that the entry of foreign firms, which in all likelihood would employ state of the art mechanized equipment, would potentially displace a large number of sanitary workers. Also, foreign firms would not find it economical to enter into the sector unless the size of the market available for provision of the service was large enough so as to ensure economies of scale.[41] The regulator suggested the integration of waste collection with waste disposal services and public-private partnerships in order to overcome some of these obstacles towards liberalization. The possibility of joint ventures involving foreign companies and city district governments was thought to be a win-win situation by the regulator. For experimental purposes, the regulator recommended pilot projects in large cities such as Lahore and Karachi.

Thus the stance of the regulator on the degree of liberalization and its terms and conditions was quite cautious and conservative. Liberalization, in its view, should not be without certain conditions, that is, there should not be an unrestricted MA to foreign investment. The Government, according to the regulator, should instead encourage foreign investors to enter into joint ventures with local firms achieved by restricting their equity share in the investments in the environment sector. The main reason given behind this conditionality was that it would eventually result in knowledge and technology transfer. Although on paper the current policy in refuse disposal and sanitation services restricts foreign ownership to no more than 51 per cent the view of the regulator was that currently foreign companies are allowed to operate with 100 per cent ownership of their investments. These two conflicting views can be reconciled by the fact that the GoP does allow complete ownership if the foreign firm registers with the Securities and Exchange Commission of Pakistan (SECP), making it thus technically a domestic or local entity.

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38 The 'vested interest' here is primarily in terms of the large labor force employed by the municipal authorities for waste collection and disposal services which in the course of liberalization or privatization would face the possibility of unemployment.

39 There is only one private waste collection firm in the city of Lahore. Their service provision is limited to a few middle and high income residential areas.

40 The standard 'equity versus efficiency' debate was invoked here.

41 A suggestion was to follow the principle of 'one city one company'. Thus the existence of economies of scale suggests that this service is essentially a natural monopoly. Therefore the efficiency gains from privatization or liberalization become somewhat ambiguous.

ii) The Private Sector

The stake holders interviewed in the private sector ranged from waste collection and recycling companies, private environment consultants to non-governmental organizations directly dealing with environment issues. The views summarized below pertain to the liberalization policy of the government in this sector.

Given the current policy of the GoP which allows foreign investment in some sub-sectors under conditions such as joint ventures with local enterprises the general view of the private stakeholders was as follows. [42]

Firstly, it was indicated that joint ventures between local and foreign firms are restricted only to cases where a foreign or a local service provider is involved in a large scale government sector project. Secondly, although collaboration is conditional upon the restriction that the foreign firm must provide minimum input into the project, these firms deliver that component of the project, which the local firms cannot because of lack of appropriate technology and/or insufficient knowledge of the area. Even with this restriction, foreign firms end up taking 20 per cnet-30 per cent of government's long-term projects. Thus the private sector was of the view that liberalization in other sub-sectors under conditions of joint ventures could lead to greater opportunities both in terms of more business and enhanced technology transfer.

Regarding the waste disposal sub-sector the unanimous view of the private sector was that collection and disposal by city municipal authorities was inefficient and poor. As the public sector lacked the capacity and resources to deal with the increasing scale of waste in the country it was considered inevitable by both public and the private sector that the latter would have to step in to fill this widening gap in the provision of this service. According to a pioneering private waste collection and disposal enterprise the private sector was effectively sharing the burden of the local government/municipal authorities and thus was gradually becoming a significant player in waste management services in Pakistan. Given the size of the market and the presence of potential economies of scale this private waste management firm was in favour of foreign companies entering the market independently or in joint venture with local private companies and/or the public sector.

Another issue raised by the private sector was the lack of proper legislation or regulatory framework which has contributed in making the existing state of the waste management service even more dismal. According to some of the players interviewed the guesstimated value of the waste collection and disposal market in a city like Karachi is a phenomenal 1 million US dollars per day. However regardless of the market size it was stated that liberalization in this sub-sector requires certain key pre-requisites to be met for it to be successful. For instance, in order to liberalize the waste-collection service it is imperative for the government (federal or provincial) to declare dumping of waste an illegal activity. This is necessary as dumping of waste by a customer means loss of revenue to the waste-collector. This requires either formulating a new regulatory mechanism or changing the existing set-up to address such specific concerns.

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[42] In Refuse disposal (CPC 9402) and Sanitation and similar services (CPC 9403) market access in Mode 3 (Commercial presence) is allowed under two conditions. The first is that foreign equity was not to exceed 51 per cent. The second condition states that entry of a foreign firm would be based on 'inquiry to gauge if direct or indirect government subsidy was being provided.'

Overall there was no perceived threat of elimination by the private sector from further liberalization as long as conditions were made equitable for all players. Furthermore, the private sector was of the opinion that the government should facilitate the bringing in and transfer of foreign technology. It should also help in improving and developing local methods of waste collection and processing. It was pointed out that the Engineering Development Board in particular could play a positive role in developing technology such as waste recycling locally while also ensuring that no sub-standard plants or inappropriate technology come out of these efforts.[43]

Thus the overall view of the private sector regarding liberalization was fairly positive. The following statement by a local environment consultancy firm aptly summarizes the opinion of the private sector.

> Environmental services market in Pakistan is currently ripe for foreign investment. Liberalization can lead not only to technology transfer but also transfer of knowledge that can help us develop technology locally.

### 8.3 Analysis and Discussion of the Stakeholders View

The main issues raised by the stake holders regarding further liberalization and their opinion on the existing policy of the GoP were outlined in detail above. Although there was a degree of divergence between the public and the private sector stakeholders on the modalities and extent of liberalization there was however an emergent consensus on certain broad parameters which have been summarized below.

Firstly, it was suggested to ‘lock in’ each sub-sector, which has a stated policy, but, to include in the liberalization plan, under the stated conditions, the sub-sectors on which there is no existing policy. Thus the advice was to widen the coverage of liberalization and not to deepen the extent of it in each sub-sector. However, it has to be stated that the public sector involved in the provision of the relevant services, for fairly obvious reasons, were the main proponents of a more conservative approach towards policies of liberalization. In the construction and engineering sector, for example, the major public sector firm was established with the primary objective of achieving self sufficiency and hence independence from foreign service providers.

Also, the smaller players in the construction sector, which make up, a major portion of the construction service industry of Pakistan, were considered to be quite vulnerable to foreign competition and thus were naturally inclined to be averse to increased foreign investment in this sector. These construction firms as mentioned before do not have any legal access to credit and

[43] According to some of the key players within the private sector appropriate technology lies at the heart of all solutions in Pakistan. These can be obtained only through indigenous R&D. An interesting example put forward to enumerate this point was Pakistan’s 1973 Energy Policy aimed at popularizing biogas in the villages. Some 10000-20000 plants were imported from Germany, however, all of them failed because the inlet for putting in cow-dung and other organic waste was much higher than the average height of Pakistani men and women. This is a classic example of inappropriate technology ruining any prospects of delivering environmental services.

thus are effectively marginalized by the GoP from the formal service sector into the informal sector. The scale of operation, low levels of technology and financial constraints of such firms act as major impediments to their growth and thus ability to compete in an open and an increasingly competitive environment.

The noteworthy exception to the view of “locking in” the sub-sectors was the private stake holders in the environment service sector, especially those in waste management services, who were fairly optimistic about the prospects of further liberalization. The main reason behind this positive attitude towards increased foreign investment was the sheer size of the potential market for waste management services and the acknowledged inability of the public sector to meet the increasing demand for the service. There was thus no threat perception by the domestic players with regard to foreign competition in any way reducing their share of the market.

Secondly, there was a consensus on the conditions under which further liberalization is allowed. The general view was that liberalization should focus on joint ventures with local firms and where there are existing equity requirements, these should be maintained. Also, it was a widely held opinion that the GoP should ensure that joint ventures are such that these facilitate the transfer of know how and technology to the local partners in Pakistan.

Thirdly, a consensus emerged across sectors and various types of stakeholders that there should be greater liberalization in regional service trade, especially with India. The potential gains of this would be in terms of transfer of appropriate indigenous technology and know how, access of Pakistani service providers to the large Indian market, and, finally, it would be a potential source of human capital i.e., trained engineers. The latter benefit would relax one of the major constraints within construction, engineering and architecture, that is, of appropriately or adequately trained personnel.

Finally, the overriding concern of a majority of the private stakeholders and even in some instances public sector players in the services sector was, firstly, their lack of involvement in the policy formulation and decision making process and secondly, ambiguity and confusion regarding the existing policies. Therefore the presence of a proper consultative process which is ‘bottom-up’ rather than ‘top-down’ is direly needed in the service sector of Pakistan.

# 9. NEGOTIATING STRATEGIES FOR PAKISTAN IN THE DOHA ROUND

## 9.1 Introduction

It is obvious that just by looking at the stakeholders' view it would be extremely difficult to formulate a comprehensive well-designed national strategy aimed at maximizing the gains and minimizing the adjustments costs. Part of the problem is that most stakeholders are constrained by limited capacity, knowledge and foresight to evaluate the implications of a wide canvas of proposals being negotiated. Furthermore, absence of in-depth sector-specific assessments makes more difficult, both for public and private groups, to analyze the market impacts of current Doha Round negotiations on Pakistan's economy.

Despite these constraints, Pakistani negotiators would like to know the negotiating strategies in terms of Pakistan's offensive and defensive trading interests to be advanced in critical engagement with its negotiating partners. In this regard, Pakistan needs to single out some key determinants of its strategy for promoting trade in services and sustainable development in the country.

While multilateral liberalization of services achieved under the Uruguay Round of talks has been quite limited, unilateral and bilateral liberalization of services sector has been the hallmark of Pakistan's policy for the last one decade. During this period, Pakistan has made significant progress toward liberalization of key infrastructural or backbone sectors, e.g., financial market, telecommunication, energy, etc. The regulatory reforms in these sectors have been introduced in phases, which have gradually removed discrimination between domestic and foreign suppliers. Liberalization in these sectors has witnessed significant influx of foreign participation apart from local institutions.

These reform efforts provide a window of opportunity to Pakistan to gain concessions from its negotiating partners by locking-in at its current level of commitments in bilateral and multilateral negotiations. Apart from using the cushion available due to unilateral liberalization, Pakistan must devise some broad guidelines to formulate its strategy for informed positioning in the negotiations. Keeping in view Pakistan's long-term developmental goals, it would be fair to say that general guidelines for a successful strategy, among other things, should focus on:

(a) national development objectives;
(b) potential for technology transfer;
(c) potential for enhancing efficiency and service quality;
(d) potential for employment generation; and
(e) presence of appropriate regulatory framework.

We now turn to examine specific requests of Members for liberalization of services trade received by Pakistan in the Doha Round in some selected/prioritized service sub-sectors with the objective to give a direction to Pakistan's negotiating strategies in the light of broad parameters outlined above, stakeholders' feedback and initial offers made by Pakistan.

## 9.2 Construction and Related Engineering Services

Pakistan has potential export as well as import interest in construction and related engineering services in multilateral negotiations. Construction sector of Pakistan represents a fundamental activity that permeates all economic sectors due to presence of strong backward and forward linkages. Likewise growth in more than one dozen other industries/sectors is directly or indirectly linked with growth in construction sector. Due to pervasive labour-intensive technology, the employment generating potential of construction sector is also immense. Therefore, mainstreaming construction services would help achieve the national development goals of high GDP growth and employment generation.

A dominant majority of contractors in construction and related engineering sector of Pakistan consists of small players mostly consisting of illiterate people lacking vision for growth and development. Because small contractors have weak financial positions, pervasive outdated labour-intensive technology, weak organizational structures, they are highly vulnerable to foreign competition.

With the exception of a few largest firms, most big players in construction and related engineering industry do not have strong financial positions to take up mega projects announced by the government. However, these constructors/operators have comparative advantage in small commercial buildings, small bridges and roads due to their reliance on labour-intensive technology.

Only a few sophisticated firms exist in the construction and related engineering sector, which specialize in large earth works and large construction works for civil engineering. Specialization and cost effectiveness of these firms enable them to compete internationally, especially in the Middle East where firms of Pakistani origin thrive on their comparative advantage largely vested in cheap skilled and un-skilled labour. An additional valuable resource for these companies is experienced engineers who have previously worked for multinational companies either in Pakistan or in the Middle East.

It should be emphasized that two most significant factors that may explain the success of Pakistani engineering companies in the Middle East are: a) acceptance of degrees and professional qualifications of engineers qualified from Pakistani institutions; and b) unrestrained flow of temporary movement of natural persons de-linked from commercial presence, and without any entry and stay restrictions on service providers. If Pakistan is to gain from the present round of multilateral negotiations, its negotiating stand in the construction sector should build around the determinants of success of Pakistani engineering companies in the Middle East.

In response to request made by the Members, Pakistan's initial offer signals liberalization commitment in MA in construction work for bridges, elevated highways, tunnels and subways (CPC 5132) and construction work for waterways, harbours, dams and other water works (CPC 5133) subject to equity/joint venture limit of 60 per cent, in addition to removing restriction on Mode 1 and Mode 2 commitments. The fact remains that these liberalization commitments offered by Pakistan do not significantly differ from the actual present policy on ground. For instance, a number of foreign construction companies, especially those of Chinese and Turkish origin have won government contracts in free bidding for construction of bridges, highways, tunnels, harbours and dams. Even though presence of foreign firms has enhanced competition in bidding for mega projects, only largest domestic firms had the capacity and resources to pre-qualify for such works. Therefore, Pakistan may conveniently want to lock-in at this level.

Pakistan has, however, maintained market access restrictions on commercial presence (Mode 3) in pre-erection work at construction sites (CPC 511), construction work for buildings (CPC 512) construction work for civil engineering (CPC 513), assembly and erection of prefabricated constructions (CPC 514), special trade construction work (CPC 515), installation work (CPC 516), and building completion and finishing work (CPC 517). These restrictions have been designed to protect small players from foreign competition, and to avoid displacement of construction workers since foreign players would have comparative advantage in mechanized constructions with highly-skilled work force.

While it is difficult to establish the extent of likely injury to small players from commercial presence in these classifications, giving blanket cover to all local players including both small and large may not be justified. While it may be feasible to maintain MA restrictions on commercial presence in the case of smaller building plans to shield small contractors, MA restriction on larger building plans may have little justification, if any.

Market access and commercial presence limitations are also maintained in Pakistan's initial offer on renting services related to equipment for construction or demolition of buildings or civil engineering works (CPC 518). However, this is not in-line with the stated position of industry players. Pakistan may want to revise its initial offer because commercial presence of foreign players in this sub-sector would benefit the industry by relieving them from major capital investments.

Although, MA limitations on foreign equity remain, yet equity limit has been raised from 51 per cent to 60 per cent, which effectively limits foreign investment to a joint venture. Pakistan seems to have maintained this limitation to encourage transfer of technology to local firms, although the policy on ground indicates that Pakistan may have kept some cushion in foreign equity requirement that it may want to use in its revised offer. Moreover, as alleged by some private stakeholders, if foreign firms enter into joint ventures only "on paper", then the expected benefits of this MA limitation may not materialize.

Besides, the negotiators should bear in mind that the requesting Members demand elimination of MA and NT limitations in this sub-sector in Mode 1, Mode 2 and Mode 3, but their request does not cover temporary movement of natural persons (Mode 4). Since all Members who co-sponsor a request are also considered a recipient of the request, elimination of this clause should be a serious concern to Pakistan as discussed below.

As noted above, Pakistan's comparative advantage in construction services essentially lies in its cheap labour and its pool of experienced professionals who hold engineering degrees and qualifications of Pakistani institutions. With the elimination of temporary movement of natural persons (Mode 4) clause from commercial presence (Mode 3), and by maintaining entry and stay restrictions on workers as envisaged in the request, Pakistan may not be able to effectively compete on foreign turf simply because they would have to use expensive labour and professional engineers of the advanced countries and thus loose their comparative advantage.

On the contrary, service providers of the requesting countries would gain from this clause by using cheap skilled and un-skilled labour of Pakistan while operating in Pakistan. Likewise they would use their comparative advantage in capital intensive constructions while operating in their home countries.

Hence it would be in Pakistan's economic interest to stay-away from a deal in which Mode 4 clause is deleted. Pakistan may only gain from these negotiations if this deal is built around factors they determine success of Pakistani engineering companies, which obviously is associated with Mode 4. Although, the Members are within their rights under the GATS to choose sectors and modes in which they want to make commitments, yet Pakistan is also free to selectively choose sectors on the basis of comparative advantage.

Finally, it needs to be stressed that the extent to which the construction sector can be liberalized would largely depend on the state of regulatory framework in the construction sector. At present the regulatory responsibilities are shared by more than one regulator. While PEC regulates professional engineers and all firms must be licensed by the PEC to operate in the country, there is no role assigned to the PEC in its bye-laws to set up the equity requirements or conditions for profit repatriation. Therefore, it is imperative that the timing of liberalization in the construction sector has to be properly sequenced before these restrictions are phased-out. Pakistan may want to use the flexibility provided by the GATS to its Members to make tailor-made commitments to reserve enough cushion for strengthening the institutional framework in the construction sector.

### 9.3 Architecture, Engineering and Integrated Engineering Services

Since architectural, engineering and integrated engineering services are of potential export interest to Pakistan, the negotiating strategies need to be conducive to match the requirements. Therefore, Pakistan may want to reconsider its current negotiating stand by repositioning itself for maximum gains from the multilateral negotiations.

As noted above, Pakistan had made liberalization commitments in the Uruguay Round on engineering services for building infrastructure (CPA 8672) and integrated engineering service (CPC 8673) subject to a maximum of 40 per cent foreign shareholding and partnership/joint ventures with local firms. Adding to these commitments, Pakistan in its initial offer in the Doha Round has signalled new commitments in consumption abroad (Mode 2) and commercial presence (Mode 3) and has also raised equity limit from 40 per cent to 51 per cent, subject to participation of local partners for architectural services (CPC 8671), engineering services (CPC 8672) and integrated engineering services (CPC 8673). Foreign firms opting to list in domestic stock exchanges are, however, exempt from maximum equity condition for CPC 8673. Pakistan has retained the condition of economic needs tests. There is also the limitation that the architects supplying service to Pakistan must have obtained certification from PCATP. The purpose of this certification requirement is to make sure that local and foreign architects are familiar with local building codes, which differ across cities.

It is noteworthy that Pakistan's initial offer does not include commitments in cross border supply (Mode 1), which warrant further analysis. Technological innovations in IT have extended the range of services that can be supplied cross border. Because architectural and engineering designs can be conveniently supplied through trans-border data flows (Mode 1), countries having relative comparative advantage are likely to gain from liberalization commitments under Mode 1. The availability of a pool of cheap experienced professional engineers and architects is the source of comparative advantage to Pakistan in this sub-sector. For the same reason, Pakistan has already begun to attract foreign capital from advanced countries for joint ventures into these sub-sectors.[44] Therefore, liberalization commitments under Mode 1 may be in line with Pakistan's export interests. These liberalization commitments in Mode 1 would also go well with Pakistan's co-sponsored request seeking Members to make full MA and NT commitments in cross border supply (both Mode 1 and Mode 2).

Finally, to further enhance potential benefits under Mode 1, it would be prudent if Pakistan also considers liberalizing its commitments even more in these sub-sectors under Mode 3. This is because arguably the possibility of increasing exports under Mode 1 would increase if more foreign firms or joint ventures in architectural, engineering and related engineering services are attracted to Pakistan.

### 9.4 Energy Services

Energy services are more likely to be of import interest to Pakistan where there is the opportunity to lock-in reforms already introduced after the Uruguay Round. As part of liberalization of key infrastructural and backbone sectors, Pakistan has undertaken reforms in electricity and oil and gas sectors to exploit its significant economy-wide gains. In this regard, Pakistan has followed unilateral liberalization of energy sector with most fundamental liberalization reforms occurring in electricity sector. Until 1994, power sector was completely under state control involving power generation, transmission and distribution of electricity. Power generation was liberalized in 1994 while privatization of WAPDA - the state owned monopoly - was initiated in 1998 for vertical and horizontal unbundling to separate generation, transmission and distribution. International competitive bidding is used to attract private power producers. Moreover, privatization of distribution companies is on the cards while the KESC has been privatized. The petroleum sector is highly regulated through interventions in pricing, returns and other administrative controls. The same is true for the gas sector, which is largely controlled by the state. Oil and gas exploration is open to the private investors. Both state and multinational companies are involved in oil exploration and gas generation. Two independent regulators are involved in rule making for the oil & gas and the electricity sectors.

Regarding the requests received from the Members, some of the requests overlap with those of construction and architecture, engineering and integrated engineering services, which will not be discussed here. Pakistan has not made any commitment on management consulting services and services related to management consulting (CPC 865 – 866). Similarly, related technical consulting services (CPC 8675 partial), maintenance and repair of prefab metal products,

[44] Based in Lahore, the JGC-Descon joint-venture between Descon Engineering of Pakistan and a leading Japanese company is an example to such a potential, which is producing engineering and architectural designs for the global market by using Pakistani engineers and architects. These designs are supplied to international clients through cross border data flows under Mode 1.

machinery, etc. (CPC 8861-8866 partial), construction work for civil engineering (CPC 5134-5136) are other related services in which no commitments have been made.

There is scope for Pakistan to consider liberalization in some of the sub-sectors in which local capacity is not present. But, in general, it is difficult to comment on the feasibility of further liberalization in these services sub-sectors through commercial presence because no sector-specific study has yet been conducted to assess their market impacts. Moreover, appropriate regulatory framework is also not present in these areas to warrant their liberalization forthwith. Therefore, Pakistan may want to use a more cautious approach in further liberalization of this sector.

### 9.5 Environmental Services

In this sub-sector Pakistan has substantial import interest through commercial presence of foreign firms. Municipal services in Pakistan have come under a great deal of stress because of continuous influx of people migrating to cities. At a sustained annual migration rate of 4 – 5 per cent, the municipal services have taken a lot of pounding. Revamping the whole sector needs a great deal of investment for which the government lacks funding. Private investment can provide solutions to these problems, but the institutional framework required for such investments is not in place. For example, there are no legal penalties for littering. The government would have to legislate and introduce laws that stop people from wasting the waste. When companies start operating the scale of operations would also be critical due to the economies associated with scale.

Presently, two types of organizational set ups deal with waste management services, which include city district governments and defence housing authority (DHA) or cantonment boards. They do not allow infringement in each others territory. Private sector firms involved in waste management services only operate when they are invited by the city district government or DHAs.

Waste collection and its recycling have a lot of scope for commercial presence of foreign companies through Mode 3. But Pakistan's initial offer in refuse disposal (CPC 9402) and sanitation and similar services (CPC 9403) does not cover public works functions owned by government, local governments or contracted out by them. Since most refuse disposal and sanitation services are under the control of CDGs this condition practically rules out presence of foreign investment. Therefore, further liberalization would be in Pakistan's interest. While in refuse disposal services only a few private companies are operating with the permission of CDGs these companies were highly supporting of a policy that favours commercial presence of foreign firms.

Similarly, Pakistan has no policy on cleaning services of exhaust gases (CPC 9404), noise abatement services (CPC 9405), nature and landscape protection services (CPC 9406) and other environmental services (CPC 9409). In Pakistan about 15 firms are involved in providing environmental services while even more firms are into environmental impact assessment services. Firms providing environmental consulting services are, however, few. Collaboration of these firms with foreign consultants is producing healthy results. Most collaborations are in wastewater treatment plants, chrome recovery plants for leather tanneries, eco labelling and energy conservation. Demand for environmental services from bigger firms has increased since enactment of National Environmental Quality Standards (NEQS). Huge investments have been made by the tanneries and the textile sectors in recent years, which have increased demand for environmental services. Because the demand is more than the supply, it is envisaged that the entry of foreign firms would be beneficial for the industry. Due to excess demand entry of foreign firms is unlikely to jeopardize the interests of local players. Due to dearth of qualified engineers in the country, many of the services are perforce contracted out to foreign consultants. Human capital constraints in the environmental services sector are acute.

Even though private stakeholders providing similar environmental services were very positive in their approach toward liberalization of this sector, the PAK-EPA was more cautious in their approach. The existing evidence shows that collaboration with foreign environmental consultants is producing healthy results and is also leading to technology transfer. Due to dearth of qualified engineers and excess demand in the local market, further liberalization commitments through Mode 1 and Mode 3 would be beneficial in terms of service quality, technology transfer and cleaner environment.

## 9.6 Temporary Movement of Natural Persons

This is an area of most interest to Pakistan due to availability of a vast pool of trained and semi-trained workers. Pakistan could expect most benefit from such flows. From the human development perspective, Pakistan has interest in liberalization of movement of natural persons (Mode 4), which at present is considered as one of the least liberal areas of the GATS [Hasnain (2004)]. The existing commitments made by the Members are mostly horizontal where not only the coverage is narrow but also is restricted to this movement in relation to commercial presence. The sectors of particular interest to Pakistan are software services, health services, legal and accounting services in which horizontal commitments attach quite tough conditions. While in the wake of globalization there has been tremendous growth in merchandize trade and trade in services, growth in labour flows has not seen a similar pattern of growth. The request made by Pakistan seeks commitments from the Members to recognize common categories, which are de-linked from commercial presence.

The flow of remittances to Pakistan has never remained stable since the early 1970s when significant temporary migration flows started from Pakistan to the Middle East mainly due to the boom in construction activity fuelled by the first oil price hike of the seventies. While these flows peaked at around US$ 2 billion in mid-eighties, there was a significant fall in these flows in the late period until there was a revival in these flows after the 9/11. Pakistan witnessed a significant increase in remittances during the last few years. Presently, remittances to Pakistan are recorded around US$ 4 to 5 billion. It is envisaged that due to the availability of huge pool of trained and semi-trained workers Pakistan could expect most benefit from temporary movement of natural persons. Pakistan's success in removal of restrictions on movement of natural persons also has developmental and poverty alleviation angels. Therefore, Pakistan may want to use this window of opportunity by taking informed position while bargaining with its negotiating partners.

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