PROJECT REPORT

RETHINKING FOREX GOVERNANCE AND FDI IN PAKISTAN, UNLOCKING NEW OPPORTUNITIES.

Issues And Solutions

Project of SAZH Consulting LLP and The Asia Foundation

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LIST OF ACRONYMS

	ACRONYM
Anti-Money Laundering Act, 2010	AMLA
Anti-Money Laundering Laws	AML
Banking Policy & Regulations Department, State Bank of Pakistan	BPRD
Bilateral Investment Treaties	BIT
Board of Investment	BOI
Certificate of Deposit of Foreign Currency	COD
Customer Due Diligence	CDD
China-Pakistan Economic Corridor	CPEC
Economic Freedom of World	EFW
Electronic Credit Information Bureau	eCIB
Financial Action Task Force	FATF
Financial Monitoring Unit	FMU
Foreign Direct Investment	FDI
Foreign Exchange Management Act, 1999 (India)	FEMA
Foreign Exchange Manual	FEM
Foreign Exchange Regulation Act, 1947	FERA
Gross Domestic Product	GDP
Information Technology	IT
Intellectual Property Rights	IPR
International Centre for Settlement of Disputes	ICSID
International Monetary Fund	IMF
Letters of Credit	LC
London Interbank Offered Rates	LIBOR
Ministry of Law and Justice	MOL

National Accountability Bureau	NAB
No Objection Certificate	NOC
Organization for Economic Co-operation and Development	OECD
Pakistani Rupee	PKR
Proceeds Realization Certificate	PRC
Protection of Economic Reforms Act, 1992	PERA
Purchasing Power Priority	PPP
Return on Investment	ROI
Securities and Exchange Commission of Pakistan	SECP
Sovereign Wealth Fund(s)	SWF(s)
State Bank of Pakistan	SBP
United Nations Development Programme	UNDP
Venture Capital(ist)	VC

MESSAGE FROM TEAM LEAD

This Report and the underlying work on Pakistan's foreign exchange regime has been an enlighteningly and necessary exercise to fathom the different factors that influence the decisions taken in this area, both by the public and private sector.

Foreign exchange is a deep rabbit hole, that we followed, yet I feel we did not reach its true depths as a study of this issue is a study of the entire economy. We are truly grateful for the support given by our private and public experts in assisting us to identify and dissect the wheat from the chaff. We went in thinking that the legal issues are abundant and that would be the extent of it. That was a naïve assumption as our experts, some of whom actively suffered due to the existing circumstances, were insistent on sharing that even if the law is perfected, the practical implementation of the same must be improved.

Our understanding of the problems grew as more diverse experts gave their feedback. From the startup sector, to the manufacturing, services and trade sectors, we were blessed to hear from as many perspectives as possible, augmented by our legal, accounting and finance experts who helped put all this in context.

Our solutions were naturally devised from the feedback from our public experts who have to manage and work on implementing the solutions. As we do more of these Roundtables our knowledge and ability to share with our experts and you, our readers grows as well.

I am honoured to put this Report and Policy Brief before you all in the hopes of helping Pakistan out of its current predicament and on to greater heights and stability. This effort would not be possible without my wonderful team comprising of our Head Writer, Mehak Zaraq Bari, and our assistant writers, Haniya Yasin, Ahsan Ali, & Maria Ahmed, including the assistance by Hussam Raza.

As before, the Report will also be available on our website at https://www.sazh.consulting/fre-report.

We hope you can appreciate and enjoy the work done, and continue to support us in unraveling the issues plaguing Pakistan. Our solutions are always based on their practicality thus there are a lot left on the table, which we feel cannot work in the existing climate. We will revisit many of them in the years to come once their implementation can appear feasible. Thank you all and we look forward to hearing your feedback.

Syed Akbar Hussain

Team Lead

SAZH Consulting LLP

EXECUTIVE SUMMARY

This report, conducted through collaborative efforts between SAZH Consulting LLP and The Asia Foundation, provides comprehensive analysis of the challenges faced by investors within the Foreign Exchange Regime which have hindered Foreign Direct Investment and eroded investor trust and confidence. The primary objective of this report is to shed light on critical policy and legal issues surrounding the foreign exchange regime and to propose viable solutions aimed at bolstering investor trust.

The insights gleaned from interviews and Round Tables with various stakeholders have been instrumental in shaping the content of this report. These stakeholders include renowned law firms providing counsel to foreign investors, accounting firms, venture capitalists, businesses spanning diverse industries, chambers of commerce, entrepreneurs engaged or aspiring to engage with foreign investors, and various government entities regularly interacting with foreign investors.

The findings and recommendations outlined in this report are intended to be disseminated among relevant stakeholders, including policymakers such as the State Bank of Pakistan, Ministry of Finance, Ministry of Commerce, Board of Investment (BOI), the Ministry of Law and Justice (MOL), and other pertinent ministries and departments. By addressing the issues within the foreign exchange regime and proposing solutions, this report endeavors to foster an environment conducive to increased investor trust and, consequently, greater Foreign Direct Investment.

Through this process we identified the following issues and developed and proposed targeted solutions through our stakeholder discussions and Round Tables.

Issue	Solution	Implementing Body
Depletion Of Foreign Reserves and Bureaucratic Red Tape around repatriations **Foreign exchange control and hindrances on remittance of funds**	*The proposed solution involves the introduction of forex credits as a financial instrument, supported by policies and regulations. This instrument aims to incentivize FDI in Pakistan by providing legal protection and the promise of repatriation, ultimately fostering a more investor-friendly environment. Furthermore, the concept envisions a dynamic*	Creation of instrument like forex credits Collective effort of: SBP; Exchange Policy Department Ministry of Commerce Ministry of Industry and Production Industry Associations Federal Board of Revenue

	marketplace for trading forex credits, enhancing liquidity and flexibility for organizations and investors alike.	Board of Investment (Federal and Provincial) And other stakeholders facilitated by the Liaison & Coordination Network & Guarantee & Vetting Module of the SAZH-TAF Model Trust System.
Trust Deficit	*Imperative to outsource trust-building measures to external states until Pakistan can regain that trust. This involves relying on other countries to act as guarantors for investments made in Pakistan, potentially through Bilateral Investment Treaties (BITs) or similar mechanisms. Under this system, host countries can assure investors that their funds are secure for-profit repatriation, possibly utilizing Forex Credits as a part of this mechanism. This trust relationship would primarily be between the investor and their home country, with Pakistan providing indemnification. This approach acknowledges Pakistan's pressing need for investment but places the burden on external states to ensure investor protection, as Pakistan currently struggles to attract investment without offering sufficient commitments for capital repatriation. This strategy is expected to be in place for at least 3-7 years to rebuild trust in Pakistan's investment climate*	Collective effort of: BOI; Ministry of Foreign Affairs Ministry of Finance SBP And other stakeholders And other stakeholders facilitated by the Liaison & Coordination Network & Guarantee & Vetting Module of the SAZH-TAF Model Trust System.
Legal Issues: Fem and Foreign regime exchange • **Complex Regulatory Framework** • **Outdated Guidelines** • **Bureaucratic Approval Processes** • **Foreign Exchange Restrictions** • **Reporting and Compliance Obligations**	*Establish consistent policies and amend the Foreign Exchange Manual to reflect the current commercial realities. Create awareness and training on the Manual so that advisors can assist investors in creating remittance plans* *The Foreign Exchange Manual (FEM) should undergo comprehensive updates to consolidate amendments and*	Collaborative endeavour between: Ministry of Finance, State Bank of Pakistan And other stakeholders facilitated by the Liaison & Coordination Network of the SAZH-TAF Model Trust System, including holding further consultations. Training to be conducted by the Model Training and Capacity Building Center of the SAZH-TAF Model Trust System.

• **Exchange Rate Risks** • **Monitoring and Enforcement** • **Inadequate Investor Protection** • **Lack of Flexibility**	*enhance its accessibility and transparency for investors and businesses. Special attention should be given to improving foreign remittance and repatriation procedures. Furthermore, the regulatory framework should adapt to various investment models like venture capitalism and private equity, offering clear exit processes for investors.*	
Policy Inconsistency and Political Instability	*The State Bank of Pakistan should streamline the repatriation process for foreign investors, emphasizing transparency and clear guidelines. Simplifying bureaucratic procedures will enhance the attractiveness of repatriation, thereby encouraging more foreign investments. To facilitate this, capacity building initiatives should be implemented for both financial and legal processes, along with advisory services to guide investors on proper channels for investment and repatriation. Additionally, offering guidance on capital management should be integrated into training and advisory services for companies seeking foreign investments.* *To enhance investor confidence in repatriation, existing Bilateral Investment Treaties (BITs) should be supplemented with additional support mechanisms. This can involve host countries providing guarantees for investments made in Pakistan through agreements with Pakistan's investment agencies. By becoming guarantors, host countries can reassure their investors.*	SBP facilitated by the Liaison & Coordination Network of the SAZH-TAF Model Trust System.
Lack of Transparency with FER stakeholders i.e SBP and commercial banks	*The Foreign Exchange Manual (FEM) imposes a cap on royalty payments that many businesses*	SBP and commercial banks SBP facilitated by the Liaison &

	find arbitrary and are unaware of. To address this issue, there's a need for awareness campaigns and capacity-building initiatives to educate the public about these provisions within the Foreign Exchange Regime. *Following this, consultations should be conducted with franchises heavily impacted by this regulation, as they are compelled to seek alternative methods for contractual payments to avoid breaching their obligations. Breaches could result in substantial damages and costs for the companies and discourage the creation or import of international brands into Pakistan seeking to enter into royalty agreements*	Coordination Network of the SAZH-TAF Model Trust System.
Lack of Investor focused incentives regards to capital repatriation	*To attract investors and facilitate capital repatriation, the Punjab Board on Investment and Trade is urged to create incentives, including fast-track access for repatriation processes. The establishment of Special Economic Zones dedicated to startups is considered vital, offering benefits like streamlined repatriation procedures and conflict resolution.* *Additionally, promoting barter trade and permitting the use of various currencies is recommended to facilitate cross-border transactions and enhance the investment climate.* *The government should adopt a more liberal approach, particularly by revising the policy limiting IT exporters to retain only 35% of their earnings in foreign exchange accounts. This change would stimulate exports, increase foreign earnings, and encourage startups to hold*	Collaborative efforts of Boards of Investment (Federal and Provincial), along with Ministry of Commerce facilitated by the Liaison & Coordination Network of the SAZH-TAF Model Trust System.

	investments in USD within Pakistan, alleviating concerns about exchange rate depreciation. *To promote business and investment, currency restrictions should be liberalized, allowing businesses and investors to freely open foreign currency accounts abroad and conduct transactions in multiple currencies. This flexibility would enable more efficient financial operations and address the limitations of the current system.*	
Obsolete FER policies unprepared for investors such as venture capital funds:	*The Foreign Exchange Manual (FEM) contains a cap on capital gains remittances that requires attention. Members leading VC firms have recommended its long-term removal, citing its obsolescence in the current venture capitalism landscape. In the short term, stakeholders like SBP and SECP should establish a regulatory framework for VC firms, akin to mutual funds regulation. These regulated VC firms should then be permitted to remit capital enhancements to external parties outside Pakistan.*	SBP facilitated by the Liaison & Coordination Network of the SAZH-TAF Model Trust System.
Lack of Transparency	*To improve information access for investors, collaboration with bankers, lawyers, and institutions like the Board of Investment is advised. They can offer guidance on remittance and investment regulations and procedures.* *Additionally, the creation of an online portal is proposed to provide ongoing updates, feedback, and a directory of registered lawyers and experts who can offer support and clarity on remittance procedures, thus enhancing transparency and investor assistance.*	SBP and commercial banks facilitated by the Liaison & Coordination Network of the SAZH-TAF Model Trust System. Training to be conducted by the Model Training and Capacity Building Center of the SAZH-TAF Model Trust System.
Startup Concerns	*During discussions with various startup entities, it became evident that they felt underserved and*	Ministry of Commerce, and Ministry of Industries & Production

	unheard, despite their efforts to promote Pakistan and attract significant foreign investment. Startups, some of which had secured investments exceeding USD 1 million, faced challenges in repatriating payments from Pakistan, causing friction with their investors. To address these issues, it was recommended during a roundtable that a startup association be established to represent their interests and needs officially.	Public sector entities like the Punjab Board of Investment and Trade supported this idea and suggested that the legal experts would assist in creating this association, enabling startups to communicate their concerns effectively to the public sector for resolution facilitated by the Liaison & Coordination Network of the SAZH-TAF Model Trust System.

In addition to the issues and solutions summarized above, the report also details various other barriers and structural issues that warrant further discussion.

OBJECTIVES

This project builds upon the SAZH-TAF Report and Roundtable on FDI issues and solutions where experts identified various issues faced by investors when transferring funds abroad as returns on their investments in Pakistan. The study aims to assess the primary hindrances, whether legal constraints or practical issues, that obstruct Foreign Direct Investment in Pakistan within the context of the Foreign Exchange Regime.

The objectives of this project were to gather data from the relevant individuals in the private and public sector, both within Pakistan and internationally through individual and informal interviews/discussions and by mediating Round Table discussions to analyze the key obstacles, legal or practical, regarding Foreign Direct Investment and Foreign Exchange Regime in Pakistan. The data is then fed into this Report, which maneuvers to effectively sift and organize the information gathered through our interviews and Round Tables. The specific objectives are listed below:

- *Conduct research and gather relevant information on the Foreign Exchange Regime in Pakistan, including policies, regulations, and procedures.*
- *Identify the key information and knowledge that investors need to know to make informed investment decisions within the Foreign Exchange Regime.*
- *Identify and analyze the barriers that impede FDI from entering Pakistan under the current Foreign Exchange Regime.*
- *Prepare a comprehensive report highlighting the obstacles within the Foreign Exchange Regime in Pakistan.*
- *Outline short-term and long-term remedies based on the discussions and refine them using SMART (Specific, Measurable, Achievable, Relevant, Time-bound) criteria.*

The report aims to provide insight into the performance of the regime, identify any regulatory gaps, and propose policy recommendations for enhancing its efficiency and alignment with international best practices. This report will enable policymakers, regulatory authorities, and market participants to gain valuable insights into the strengths and weaknesses of the current foreign exchange regime. The findings of the report can serve as a foundation for future reforms and initiatives aimed at improving the efficiency and effectiveness of the regime, thereby supporting sustainable economic growth and stability in Pakistan.

ABRIDGED REPORT

For the sake of brevity, we have uploaded the wonderful work our team did on the Background, Methodology and Literature Review to our website, along with our other FDI Reports.

We highly recommend you peruse it as it contains our analysis on the Foreign Exchange Regime, the Statutory Framework including the past, as well as lessons and recommendations from other countries.

The unabridged SAZH-TAF FDI-FER Report and Policy Brief is available at [Foreign Direct Investment & Foreign Exchange Regime | SAZH](https://www.sazh.consulting/fdi-fer) (https://www.sazh.consulting/fdi-fer) and the QR code linking to the same below.

ISSUES

Depletion of Foreign Reserves and Bureaucratic Red Tape

- Over the past two years, and especially in the last 12 months, Pakistan's foreign exchange reserves have reached their lowest point, with several instances where the nation possessed reserves sufficient for only a month's worth of imports. Faced with mounting pressure from opposing political parties and the general population, the government has been striving to exercise prudence concerning the country's foreign exchange reserves. As a result of these economic challenges, the State Bank of Pakistan (SBP) has employed a tacit restriction on the repatriation and outward remittance of profits, dividends, and debt reimbursements to reduce the depletion of the country's reserves even further. In instances where repatriation has been achieved, the process has unfolded at a considerably slow pace, owing to the State Bank's reluctance to expedite proceedings due to the aforementioned economic and foreign exchange issues.
- Investors and companies issuing shares for investment are required to register with the State Bank of Pakistan and with the Securities & Exchange Commission of Pakistan (SECP) to allow for repatriation of profits and dividends. While cross-border payments related to interest, profits, dividends, and royalties do not require prior notification, banks must report loan information to enable the SBP to verify remittances against repayment schedules. Although no formal policy prevents profit repatriation, companies have faced challenges in repatriating profits due to unclear regulations and coordination issues between the SBP, Ministry of Finance, and other government bodies.
- Categories for repatriation of profits include dividends, profit remittances, debt servicing, capital, capital gains, divestment and returns on intellectual property. There are different priorities of clearance allowed by SBP for each category.
- Significant transactions that could impact Pakistan's foreign exchange reserves require approval from the Economic Coordination Committee of the government. Similarly, banks are required to account for foreign currency outflows. Investor remittances must be registered with the SBP within 30 days of execution and must align with a valid contract or agreement. This applies to both inward and outward remittances.
- Most of the larger multinationals that have been here since 1947 are facing issues of repatriation, but have learnt to cope with the volatility, uncertainty, and complexity of the changing economic situation within Pakistan. However, this coping is more a function of their size which allows them to absorb such impact in a far better manner than smaller organizations

to whom delays in profit repatriation can impact operating costs, sustainability and return on investment.

In addition to the tacit restriction on remittances of profits, letters of credit have been disallowed in many cases which has restricted the import of raw materials and has affected the business operations of businesses, apart from blocking profit repatriation. Given a choice between importing raw materials and remitting profits, in an article published by Dawn Newspaper, Pakistan Business Council said their member firms will prioritize the former, given that business continuity is more important for them at this time. However, overseas investors have registered their protest with the SBP and have continually asked them to allow partial remittance of dividends, at least until the economic situation eases. The FEM also has specific categories with caps on the categories that need to be reviewed as currently they restrict the amount that can be repatriated when it comes to capital gain and royalty payments.

Legal Issues: FEM and Foreign Regime Exchange

The laws and regulations outlined in the Foreign Exchange Manual (FEM) and the Companies Act, 2017, deter Foreign Direct Investment (FDI) in Pakistan and create significant hindrances for foreign investors. Here's a comprehensive analysis of how these laws can discourage FDI:

Complex Regulatory Framework:

- The presence of multiple laws, amendments, and regulations, such as the Protection of Economic Reforms Act (PERA), the Foreign Exchange Manual (FEM), and Anti-Money Laundering (AML) Laws, can create a complex regulatory environment. Foreign investors may find it challenging to navigate this intricate legal landscape, leading to uncertainty and potential delays in investment decisions.

- The Foreign Exchange Manual (FEM) presents a highly intricate and multifaceted regulatory framework for foreign exchange transactions. The FEM is a document that is a compilation of various SRO's. This means that the document is subject to frequent changes. Hence the structure of the FEM lacks consistency and is essentially a fluid document that can change following every notification issued by the SBP, requiring a new updated revision. This has led to a lack of clarity on the final version of the FEM that is applicable. According to a stakeholder that was interviewed, the SBP is also internally unclear at times on what is the most recent updated version of the FEM, because of the frequency of its updates.

- Another major concern is the lack of awareness and understanding among investors regarding the FEM and its clauses. Many individuals and businesses may not be familiar with the regulations, which can create barriers to foreign exchange activities.

- Moreover, the FEM can be complex and challenging to comprehend for non-experts. The FEM's terminology is at times inconsistent, and there is repetition in the regulations. Clearer cross-references and a more streamlined structure could enhance its usability. This complexity may deter smaller businesses and individuals from engaging in foreign exchange transactions, as they often require legal or financial expertise to navigate.
- Furthermore, the complex approvals and procedures related to foreign exchange transactions are contradictory sometimes and time-consuming as they involve different entities on federal and provincial levels. This can discourage foreign investors and create inefficiencies for businesses.

OUTDATED GUIDELINES

- The FEM may not always keep pace with rapidly evolving global financial practices and technological advancements. Outdated guidelines can lead to confusion for market participants and may not reflect current market realities.

- Freelancing where inward remittances are primarily involved, are also facing issues because of the lack of clarity around processes and allowances in the FEM. This has led to Pakistan Freelancers Association also voicing their concerns in the wake of the current economic climate. The association is of the view that Pakistan has great freelancing potential and the ability to bring in considerable forex into the country's reserves, however because of unclear and inconsistent policies as well as Pakistan's FATF status, inward remittances are also being treated cautiously.
- The Foreign Exchange Manual does not consider newer models of investment like venture capitalism and private equity as the FEM has been geared towards investors without the consideration that they would want to exit at some point.
- The FEM restricts IT sector exporters from retaining only 35% of their profits in foreign exchange accounts. This limitation prevents startups and IT companies from fully benefiting from their export earnings.

BUREAUCRATIC APPROVAL PROCESSES

- The requirement for investors to submit applications, provide extensive documentation, and go through verification processes involving the State Bank of Pakistan (SBP) and other relevant authorities can lead to significant delays and administrative burdens. These bureaucratic hurdles can discourage potential investors who seek a streamlined and efficient process.

FOREIGN EXCHANGE RESTRICTIONS

- FEM allows the SBP to impose restrictions and limitations on foreign currency transactions, including remittances and profit repatriation. Such restrictions can reduce the flexibility and attractiveness of investment in Pakistan, as investors may fear challenges in repatriating their profits or moving funds in and out of the country.

REPORTING AND COMPLIANCE OBLIGATIONS

- The manual places substantial reporting and compliance obligations on investors. These obligations include providing periodic updates on investment portfolios, changes in ownership, and significant transactions. The strict adherence to these requirements can be cumbersome for foreign investors and may lead to concerns about compliance risks.

EXCHANGE RATE RISKS

- The process of converting foreign currency into the local currency and the associated exchange rate considerations can add an element of risk to foreign investments. Investors may be concerned about the potential impact of currency fluctuations on their returns.

MONITORING AND ENFORCEMENT

- The FEM, AML and FERA all emphasize monitoring and enforcement by relevant authorities. While this is essential for maintaining transparency and compliance, an overly stringent approach could create a perception of intrusive oversight, potentially dissuading investors.

INADEQUATE INVESTOR PROTECTION

- The Companies Act, 2017, and related regulations do not provide robust investor protection mechanisms, leaving investors vulnerable to various risks, including legal disputes and governance issues.

LACK OF FLEXIBILITY

- The legal framework outlined in the FEM and the Companies Act lack the flexibility needed to adapt to changing market conditions or evolving business needs. This rigidity can deter investors who seek adaptable regulatory environments.

While regulations are essential for ensuring transparency and stability in the foreign investment landscape, the complex and bureaucratic nature of the laws outlined in the FEM, FERA, PERA and the Companies Act, 2017, can deter FDI in Pakistan. To attract foreign investors, it may be necessary to streamline and simplify these regulations, provide clearer guidance on tax matters, and enhance investor protection mechanisms.

Policy Inconsistency and Political Instability

- The means to consistently assess the method and process of remittances have not been provided by SBP or the relevant governing authorities.
- Investors, because of inconsistent policies and the lack of a process and method of remittance that is also being implemented, prefer to park their investments in other countries.
- Pakistan's political instability in recent times does not provide a conducive environment and confidence to prospective investors, who are looking at a long-term view.
- Stability is a critical factor for attracting foreign direct investment. Investors seek predictability in currency values to assess their potential returns accurately. Exchange rate volatility can deter foreign investors. Rapid currency depreciation can erode the value of investments and reduce the attractiveness of Pakistan as an investment destination. Investors may also face difficulties in repatriating profits and dividends in a depreciating currency. It is also one of the main reasons stated as to why investors park their funds in other stable countries and only bring in the bare minimum expenses for their businesses in Pakistan.
- Pakistan's foreign exchange regime does not provide mechanisms to mitigate exchange rate risk, which deter investors. Investors need tools such as forward contracts or hedging options to protect their investments from adverse currency movements.

Lack of Transparency with FER Stakeholders I.E., SBP and Commercial Banks

- In recent times, SBP has shifted the onus of repatriation (for inward and outward remittances) onto banks, whom they name as 'authorized dealers' in their documentation.
- Banks however, are also struggling to navigate the process and end up going to SBP for confirmation and approval on various repatriation requests as they do not want to end up approving any requests which SBP may object to in future audits, hence resulting in hefty fines for the banks.
- The SBP has implicitly outlined a zero sum 'policy' to banks for ensuring that outward remittances do not exceed inward remittances. Banks, as authorized dealers, have been asked to 'balance the books' which has led to them being very cautious about allowing repatriation. Although the process between the banks and the SBP is somewhat opaque, several examples of banks refusing to cater to repatriation requests from investors were quoted during stakeholder consultations held for this activity.

Obsolete FER Policies Unprepared for Investors such as Venture Capital Funds

- Pakistan's Foreign Exchange Regime has failed to evolve and is not ready to cater to newer financial and investment models such as venture capitalism which depend on swift exits after short term investments rather than longer term investments based on return on equity.
- For venture capitalist (VC) funds, acquisition and IPO are the two basic exit strategies of the investment to get the return on investment (ROI). Pakistan's Foreign Exchange Manual however says that investors cannot take back the principal amount, they can only repatriate the profit. This issue also ties into reasons why a VC, once it decides to invest in a startup in Pakistan, always keeps its funds in their home country or a location with more consistent regulations like Singapore, Dubai and Delaware. Any funds required for operations are remitted to Pakistan on a need basis, however the entire investment never makes it to Pakistan in one chunk.
- Issues in repatriation of profits have meant that the startup ecosystem have had to register holding companies abroad in locations such as the ones mentioned above to appease and attract investors. One startup founder explained that this has become somewhat of an unsaid requirement that investors evaluate potential startups on. As this has led to a temporary way around the problem, this issue is not being highlighted or addressed much by P@SHA, which is the primary body for taking up IT related issues with the government. Tech led startups do not have an association of their own, however, most of them are members of P@SHA as the organization has a long-standing relationship with the government and has successfully negotiated policy related issues for the IT sector in the past.

Lack of Transparency

- The manner of remittances is an opaque transaction between the commercial banks and the State Bank of Pakistan.
- The SBP has implicitly outlined a zero sum 'policy' that they expect banks to maintain and ensure such that outward flow of forex does not exceed inward flow of forex.
- This has been a difficult tasks given to banks, and has resulted in complications within the system, as there is still an approval process with the SBP that must be followed, leaving the companies that want to make transactions in the dark.

Startup Concerns

- Startups are the thriving future of Pakistan, however they face a lot of operating difficulties in Pakistan, in particular if they are looking for FDI.
- Startups are required to create off-shore companies and restructure their corporation in a way that they are principally based outside of Pakistan, with the Pakistani company acting as a subsidiary of the foreign company. Various individuals starting their companies do not have the knowledge for such an endeavour.
- The reason for this is investors lack of trust in Pakistan. The investors demand that startups be based in Singapore or Dubai, or any other jurisdiction that does not have the restrictions on remittance of capital or finances as Pakistan does. Nor does it share the abysmal reputation of Pakistan’s finance sector and dispute resolution sector.
- This results in startups incurring substantial costs and time delays, even before they have started operations or making money.
- This further erodes Pakistan’s trust and places significant hurdles on the incubation and growth of various companies that now have operating costs higher than the rest of the region such as India or Bangladesh and yet, must compete with the same in the global scale.
- Our experts from the startup sectors shared that their concerns are widely unheard and their efforts of brining FDI into Pakistan are not respected. Thus a forum is required for their concerns to be addressed.

SOLUTIONS

Introducing a New Financial Instrument: Forex Credits

- The main solution that came up in discussions with the private sector on what measures can be taken to counteract the issues identified, was the creation of a new financial instrument, which can take the form of 'forex credits'.
- Since the SBP wants to implement a zero-sum game where there is a balance of in-flow and out-flow of foreign exchange, and since many organizations (because of economic and policy related issues) prefer to park their investments in other jurisdictions, hence the logical solution is to create an incentive in the form of a financial instrument backed by policies and regulations for enhancing FDI which could then be used to justify the repatriation of profits.
- The idea is to create policies, develop regulations and provide legal cover for investors so they can bring their investments directly to Pakistan with the incentive that they can repatriate as much as they bring in.
- This new financial instrument can be implemented and regulated by the associations initially and can then evolve into a marketplace where forex credits are traded between investors through the use of blockchain technology. Opening up the trading of forex credits can encourage new avenues of revenue for organizations who have piled up a significant number of credits which they do not need immediately. These credits, once traded, can become valuable assets to organizations that can use them immediately to repatriate profits and placate their investors.
- The associations present during the Roundtable agreed that a pilot project be started within them, by which they can be used to allow members that import forex (USD) into Pakistan to register the same with the association. This information can be recorded on a blockchain to allow modern technology to assist in creating modern solutions, as blockchain will then allow the system to work seamlessly, and limit potential for abuse. The association can then liaise with the State Bank of Pakistan, SECP, FBR and any other regulating authority to allow the creation of redeemable 'tokens' by which the member who has imported forex, can then be allowed to redeem the same and export forex, thus promoting a zero sum game. Thus, this plan was discussed and agreed upon by our members, and the Forex Credits became a viable solution to our existing problem.
- The Forex Credits, whether as blockchain tokens or some other mode that is implemented, can then be part of an exchange under which the market can bid and buy the same from holders of the Credits. The Credits can be implemented with an expiry date by which they must be

redeemed, so that hoarding of Credits can be minimized. Further features can be added as necessary.

- The members of the associations will also thereby be incentivized to register their contributions to the foreign reserves, which will allow the economy to track and monitor such transactions better, and minimize the use of other modes and manners available in the market, that are detrimental to the economy, such as the informal/illegal modes of repatriation.
- The SOPs and manner by which such Credits are registered and created can be a joint exercise with the commercial banks, SBP and other relevant stakeholders with the associations as the focal body in custody of this system, and augmented by the support of these organizations.

Pakistan's Trust Solution – Outsourcing Trust

- It is evident from the literature and our conversations with the Experts that Pakistan faced a Trust Deficit. The solution to that became the necessity of outsourcing the need for trusting Pakistan, until such time that we have regained the trust.
- In essence, that means relying on another state to act as our guarantor. This can operate through the BITs, or any other state-based mechanism, by which the host country from which investment is coming to Pakistan, can assure and guarantee the funds are safe for the purposes of remitting profits or capital outside Pakistan.
- This can be established using the Forex Credits, the redemption of which can be part of the mechanism that host countries can offer the investors such that the trust relationship is between the investor and his state country, which in turn is indemnified by Pakistan. The states, by virtue of their BITs and dispute resolution processes through ICSID are better positioned to process delays and damages, with Pakistan, rather than individual investors who may not be in a position to leverage the same.
- This system relies on Pakistan's need for investment. The system is not favorable to Pakistan, yet it is being proposed as the need of the hour, as attracting investment, without providing adequate commitments as to repatriation of the same, is the catch-22 that Pakistan currently suffers from. It is expected that this will be necessary for the foreseeable future by at least 3-7 years.

Creation of Association for Startups

- It became evident during our conversations with various startup entities that they felt underserved and unheard, when arguably they had been working to promote Pakistan's image and attract millions of foreign investment.

- Thus during the RT, it was recommended by the startup industry that to put forward their interests and needs an association for the same be created. The startup members present had secured investment more than USD 1 million, yet they were not being allowed to repatriate any payments outside of Pakistan, which was creating friction between the startups and their investors.
- Thus the members of the public sector including the Punjab Board of Investment and Trade, recommended that the startups create an association which then puts forth its problems officially so that the public sector can then respond.
- Thus it was clear that our legal experts will assist the startup sector in the creation of their association.
- This will address concerns by startups that are not rooted in IT, such as agriculture, manufacturing, etc.

Streamline the Repatriation Process and Ensure Consistency in Policies and Implementation

- The State Bank of Pakistan should be able to simplify the repatriation process for foreign investors, ensuring transparency and clear guidelines. Fewer bureaucratic hurdles will make repatriation more attractive, encouraging more foreign investments. Capacity building of the financial and legal processes to follow and advisory services on how to bring investment and repatriate through proper channels needs to be made available. Structuring of capital management should also be part of the training and advisory services to companies.

- Existing Bilateral Investment Treaties (BIT) should be augmented with another support system, through which investors from different countries that want to invest in Pakistan, gain confidence about repatriation. This can be done by providing guarantees, preferably by the host country who may enter into an agreement with Pakistan’s investment agencies. Thus, the host investment country can be the guarantor for the investments made in Pakistan. Currently the options are starting ICSID arbitrations, which are lengthy, expensive and unavailable to investors. A similar dispute resolution mechanism can be created within such a BIT system.

Update the Foreign Exchange Manual (FEM) and Regulatory Framework

- The FEM needs to be updated, by consolidating all amendments and making it easily understandable, transparent, and accessible to investors and businesses with special emphasis and a revision in the process and clarity of foreign remittance payments and repatriation procedures.
- The Foreign Exchange Manual and existing regulatory framework should also take into account different investment models like venture capitalism and private equity, and should provide adequate processes and means for investors to make exits from investments
- The government should consider taking a liberal approach to issues such as IT exporters only being able to retain 35% of their earnings in foreign exchange accounts. A revision in this policy will encourage exports, which will lead to more earnings and foreign exchange. Uncapping this, will also allow startups to hold their investment in USD within Pakistan and will encourage investors to invest in Pakistan without the fear of losing money due to exchange rate depreciation.
- Liberalizing currency restrictions to allow businesses and investors to freely open foreign currency accounts abroad and conduct transactions in various currencies would enable them to handle their financial needs more efficiently and overcome the limitations of the current system.

Exemptions for VC Firms

- Within the FEM, there is currently a cap on the remittance allowed on capital gains which must be addressed.
- Our members that were heading VC firms recommended that long-term the cap on capital gains must be removed as it is an obsolete measure that cannot persist in the current venture capitalism market.
- In the short-term, the relevant stakeholders such as SBP and SECP, create an option for regulating VC firms similar to how mutual funds are regulated. These regulated VC firms should then be allowed to remit enhancement of capital to their parties outside Pakistan.

Cap on Royalty Payments

- The FEM places a cap on royalty payments, which unfortunately many businesses are unaware of, and also object to, as being arbitrary.
- Awareness sessions and relevant capacity building must be done so that these provisions within the Foreign Exchange Regime are known to the public.
- Followed by consultations with the various franchises that are heavily affected by this law who are thus forced to use alternative means of making their contractual payments, and not be in

breach. Breaching the contractual obligations will result in hefty damages and costs to the company, as well as reduce the creation or import of international brands into Pakistan, that wish to enter into royalty agreements.

Incentives for Investors

- The Punjab Board on Investment and Trade was requested to create incentives for investors such that they can be provided fast-track access to process of repatriating money outside Pakistan.
- Establishing Special Economic Zones dedicated to startups became essential which will include benefits such as simplified repatriation and conflict resolution.
- Allow barter trade and the use of different currencies to facilitate cross-border transactions.

Transparent and Easy Access to Information

- Enhance information access for investors by engaging with bankers, lawyers, and institutions like the Board of Investment, which can provide guidance on regulations and procedures for remittance and investment.
- An online portal can be created that can provide feedback and updates on progress as well as highlight registered lawyers and other experts that can provide support, clarity and advice on procedures for remittance.

Capacity Building

- Various sectors expressed an interest in capacity building of their staff and founders, in the areas of remittance as well as corporate and accounting structuring such that they can minimize their risks of breaching obligations when it comes to remittances or payments to be made outside Pakistan.
- In particular, our experts working in the areas of women-focused businesses expressed that there is a particular gap of information as to FDI and its surrounding parameters so particular focus of training ought to be done.
- Training modules for the manner in which companies should be structured to increase chances of FDI, such as off-shore holdings to enhance investor confidence, should be created and disseminated amongst the chambers and association, with particular attention given to women chambers.

- Training modules on the accounting practices to be adopted and the law relevant to companies interested in FDI, and the complications they will be facing when making any payment outside Pakistan should be created and disseminated.

CONCLUSION

It became clear during our conversations that our experts wants to delve into the practical issues, rather than the purely legal issues. The practical issues being a lack of transparency with the State Bank, as well as lack of consistency in policies. This is aggravavted by the sympathetic position of the SBP, which must exercise capital control over our foreign reserves, and must react according to the volatility in the current market conditions.

Thus it became essential to understand that the problems lies in depleting foreign reserves, and a solution must be generated to address the same. Our experts in various associations shared that they were prepared to take the onus of regulating and managing the outflow of forex, if there was a benefit created for the entities that were importing forex into Pakistan. A common complaint was that while certain businesses, such as our startups, were bringing in FDI into Pakistan, they were restricted from taking out the same money, and someone else in the market was allowed to do so. Thus they clearly pointed out, there is no incentive for a company to bring in FDI into Pakistan, and improve the state of foreign reserves, if they were not allowed to benefit from it. Thus came the birth of forex credits, which is a means of incentivizing companies from bringing in FDI or forex, and improving our state of foreign reserves, while also giving them the option to redeem the same within a certain time period. If a ratio is created and negotiated with the associations, then a net positive result in foreign reserves could also be accomplished under the same system.

Then subsequently if a market for the same is allowed to flourish then the incentive for registering the transactions increases, and a lot of the grey market would shift to the documented economy. The current rise of blockchain based technologies and the various digital tokens and currencies allows this technological option to exist, and Pakistan, should be at the forefront of it.

Other areas, such as the startup associations, the amendments to the FEM are essential for the continued success of Pakistan’s ecosystem. The fact that VCs cannot benefit from the capital gains of their investments, as they are hindered from remitting the same abroad is another example of Pakistan’s obsolete structure. Our VCs are prepared to undergo the necessary regulatory reforms and requirements to become registered and regulated as any other investment fund, so that they are allowed to repatriate their capital gains to their foreign investors. This is essential for the trust system of Pakistan to grow.

In essence, we learned a lot, and there is undoubtedly a lot more to be uncovered. Our SAZH-TAF Trust System continues to grow, and flourish with new experts and new areas of reforms required to enhance Pakistan’s FDI regime such that our country can attain its potential. Our youth is the most energized yet we lost them with our inability to evolve. The loss of our human resource to other countries due to lack of opportunity in Pakistan, was factor particularly shared by various experts, private and public.

The fact that we live in a global village, and must compete with the rest of the world for resources, manpower, intellect and finances, should readjust our thinking, and allow us to innovate beyond the traditional pale.

We hope that this effort of ours helps in steering Pakistan to a destination that can allow us to not make short-term decisions based on our foreign reserves, while strengthening our financial position. We have our neighbours to thank for the inspiration that it is possible. We just need to implement, and be consistent about it. We look forward to your feedback and hope to bring you further details of our work in various other ambits as well. Thank you all for your support.

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SOURCES

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BIBLIOGRAPHY

The Bibliography can be found in detail at [Foreign Direct Investment & Foreign Exchange Regime | SAZH](https://www.sazh.consulting/fdi-fer) (https://www.sazh.consulting/fdi-fer) and the QR code linking to the same below.