The Potential of Pakistan in China Pakistan Economic Corridor (CPEC)

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***Abstract*--The study explains the legal frame work and institutional potential of Pakistan. The study explains how reforms would work well in areas such as taxation, bureaucratic red-tapes, court procedures and property laws, however, where the Bilateral Investment Treaty (BIT) and Free Trade Agreement (FTA) and broader principles of engagement stand; new plans and laws need to be drown from the top-down and local legislative bodies to make the most out of CPEC.**

***Keywords*--Legal framework, Bilateral Investment Treaty (BIT), China Pakistan economic corridor**

1. INTRODUCTION

Globalization has revolutionized the global political economy with a strong emphasis on borderless development. 21st century is the advent of China as the world's economic powerhouse. The year 2014 stunned global financial capitals as China overtook the mighty US economy. Only a decade ago, China's economy was half the size of the US and it was the sheer pace of economic growth and development which stunned the world. China achieve this rank by fulfilling massive demand of cheap imports of value-added and manufactured goods for the developed world and also for the developing economies. This is exemplified in how China has overtaken the status of the most dominant and largest trading partner, in terms of value and volume, for more than half of the globe[1]. This has in turn meant an ever-globalized Chinese economic ambitions, as seen as President Xi Jinping 'Grand Strategy'; developing China and the region around her via the One Belt One Road Initiative (OBOB/BRI)[2].

With global borders fading with the rise of market forces of international trade and investment, what becomes crucial is how national economies cater to foreign investment and what challenges or opportunities their existing legal frameworks pose. This study aims to find how far Pakistan has evolved its legal framework which allows trade and investment with the china. As Pakistan being a focal part of the BRI plan, it is essential to understand Pakistan's institutional capacity; does it challenge incoming investment or assist investors in doing business? The conclusion this study finds is that with great improvement and comprehensiveness in the legal framework of Pakistan enhance its potential towards welcoming the foreign investment is commendable, however, several crucial contentions and contradictions within the system prevent the true potential of CPEC.

2. Literature review

With comprehensive research and literature published on China's BRI project and its regional and international implications, this study categorizes crucial themes within the following spheres of debate. Firstly, research revolves around what the BRI means for Pakistan. Is it really a next big thing? Secondly, does the institutional support of Pakistan offer opportunity or a barrier to incoming Chinese investment. Looking at the first sphere, writer Lu Shulin seems to support the idea that the CPEC does hold a focal position with Chinas larger BRI ambitions. Apart from advancing China's own economic influence over the countries the BRI connects, various writers agree to how the former Prime Minister of Pakistan Nawaz Shariff, had titled CPEC as a "game-changer" for Pakistan, at the inaugural session of CPEC in 2015, where also present was the Chinese President Xi

Jinping. He explained that CPEC holds for Pakistan, what BRI offers the world; development and growth. Within China's Grand Strategy, a system of broad coordination of policy, infrastructure linkages, facilitation of trade, financial integration, cultural and technical exchanges is key. For Pakistan's struggling semi-industrialized and predominantly agrarian economy, this would mean massive modernization in terms of enhanced access to trading markets and mass industrialization via establishment of economic zones and power production units[3]. However, the writer does not address the challenges CPEC would encounter while it deals with one of the strongest economies of the world; one of domination and utter dependence. Indeed, Shulin represents a greater win for Pakistan and leaves out China's interests in his arguments.

For a more comprehensive view we look at writer Andrew Small of the Asia Policy Institute, where we see a more detailed assessment of Chinas advantages. Small explains China has more long-term ambitions, for which it makes CPEC a prominent part of the BRI. It looks to have strategic leverage, after loaning massive investment funds to Pakistan, and then brokering political and territorial agreements in exchange. Interestingly, Small predicts a similar pattern with other developing nation which join the BRI[4].[1] To ascertain which party is at advantage or at loss within CPEC, only an effective and transparent legal system within which CPEC investment flows into Pakistan and is recorded as well as governed, can allow.

This brings our review to the second set and most important of literary discussion; will the legal system provide an actual opportunity to Pakistan and not pose a barrier to Chinese investors from doing? Ahmad Ghouri in the Chinese Journal of Comparative Law explains how Pakistan has a largely open foreign investment regime. This provides an attractive route for incoming Chinese investment, however, as the same time it poses questions of how far the legal system will not expose the Pakistani economy to Chinese domination and/or manipulation. What makes it open is that there is no limit or restriction of owing property, generous tax regime, providing protection for foreign investment by the help and legal cover of the due process of law and compensation rights, all allow Pakistan to be an attractive destination for Chinese FDI. Additionally, Pakistani law covers World Trade Organization's articles of fair trade, international arbitration and intellectual property rights. However, we see limited mention of transparency, anti-corruption mechanisms and low trust and efficiency of local court system, resulting in a reliance on international arbitration tribunals. Also, there is a gap between linking local laws allowing ease of business and exclusive legislation for CPEC itself, which functions almost parallel to local corporate laws. Interestingly, our research supports the idea that investment in itself is not enough for development, rather, ease of doing business within the legal system is of parallel importance. Adrian Corcoran and Robert Gillandersprove in their research that data from 2004-2009 shows that the state and level of regulation affects FDI inflows into economies. It was in fact the ease of trading across borders was found out to be a key indicator of international trade and investment. For example, for middle income countries, the researchers found strong forces of FDI at play but was weak for more institutionally weaker middle income and Sub Saharan countries[5]. When it comes to Pakistan, Ghouri had already explained that if Pakistan does not maintain CPEC open, transparent and well-governed, it may appear that China is dominating and even scare other BRI partners away. If the rule of law is not maintained, such transit corridors may not reach their true potential. There is no doubt, after understanding Rao Qasim Idrees, Rohimi Shapiee, Haniff Ahamat and Luo Hanwei study on how Pakistan is one of those countries who have not fully developed road transport neither the system to enforce them, that Pakistan has a long way to go. Before celebrating and welcoming huge Chinese investment and expecting heavy flow of goods and passengers in the transit corridor, considerable attention is yet to be given to transport laws, bilateral trade treaties between China and Pakistan, free trade agreements and free trade area contracts, early harvest programs and preferential trade agreement between these two countries. Only then can we ascertain the system has the capacity to promote FDI.

With the three themes; Firstly, what the BRI means for Pakistan. Is it really a "game changer"? Secondly, does the Pakistan legal system offer opportunity or a barrier to incoming Chinese investment. Finally, does the Pakistan have such institutional potential to grab the opportunity; we can now move on to where this study will allocate its main focus. There is an inherent research gap between what CPEC means for Pakistan, China and the region at large and the anticipated economic development and benefits. It is primarily the question of ease of doing business within the legal framework of CPEC and commercial tax regime. This in itself is such a major factor which will decide the actual potential of the project to be realized while also answering the question of how far China could dominate the Pakistani economy and local political landscape at large. And so, the framework of this study begins with understanding the current legal framework of Chinese investments. It then moves onto analyze laws and regulations which either support or negate the idea that Pakistan has a credible, effective and consistent legal system. Challenges and opportunities for both china and Pakistan will be studied and then comprehensive proposals will be provided from the academic and practical circles.

3. Legal framework of CPEC involving Chinese investment

Laws:

CPEC consists of a $ 46 billion inflow in Pakistan; it will be used for highways, power plants, communication facilities, economic and industrial zones, intensive land and sea development of Gwadar to make it an international port, etc. In its entirety, Chinese companies will be financed by Chinese banks for investment purposes, similar to how other companies do. The next section includes the discussion of legal structure of Gwadar port.

Legal structure of Gwadar port:

The Gwadar port investment is directed from foreign source and so the prime body and laws applicable is that of the Pakistan Board of Investment (BOI). The BOI in itself protected by landmark legislation of the Parliament of Pakistan; "Foreign Private Investment (Promotion & Protection) Act 1976" along with the "Protection of Economic Reforms Act 1992". These Acts form the umbrella under switch the entire legal premise of CPEC is structured. Among one of the most crucial provision is that of section 5 of the 1976 Act. The government is not allowed with or without force to acquire any property of the foreigner except under provisions laid down by due process of law. Additionally, provisions of fair compensation in the form of the currency which is of the origin of investment is also applicable by law, without delay. Also, any agreement signed and entered by the Federal Government (and Provincial Governments) with the concerned foreign investor/company is protected by the law of the land[6].[2]
Under Section 6 of the 1976 Act; "a foreign investor in an industrial undertaking approved by the federal government, subject to the provisions of the 1947 Act, may at any time repatriate in the currency of the country from which the investment originated:

a) Foreign private investment to the extent of original investment
b) Profits earned on such investment and
c) Any additional amount resulting from the reinvested profits or appreciation of capital investment".[3]

Another landmark provision is seen in the Constitution of Pakistan itself. Article 199 of the Constitution effectively authorizes all provincial High Courts to admit cases of violations of legal rights of foreign investors/companies.[4] They have additional jurisdiction to override any unlawful conduct by a senior official(s) if no other remedy is available. This is substantial protection of foreign investment, equal to all protection applicable to local businesses.
The Pakistan BOI Investment policy of 2013 made the already open economy much more liberalized and opened up all sectors of the economy to direct investment and even ownership, apart from public safety and national defense. There are a total of 68 sectors outlined, Chinas has unprecedented access to 61 of them, especially mining and exploration, communications, energy tourism, health and business[9].

Regulations:

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On the whole, foreign investment in Pakistan is regulated by following three acts of parliament:

1. "Foreign Exchange Regulation Act of 1947 (the 1947 Act)",
2. "The Foreign Investment Protection and Promotion Act of 1976 (the 1976 Act)"
3. "The Protection of Economic Reforms Act of 1992 (the 1992 Act)".

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Also, any agreement signed and entered by the Federal Government (and Provincial Governments) with the concerned foreign investor/company is protected by the law of the land[10].

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1. "The signatory countries shall encourage investments in their sovereign territories by investors of the other signatory country"
2. "Non-discrimination between domestic and foreign investors among signatories"
3. "Equal and non-discriminatory treatment in case of compensation for losses occurring due to war or other armed conflicts and/or a state of national emergency"
4. "Free transfer/movement of investments and income (including profits), dividends, interest income, proceeds of sales or liquidation, repayments of loans, salaries, wages and other compensation"
5. "A dispute settlement mechanism to settle any dispute between the signatories by considering the interpretation of the respective agreement and an official and mutually agreed dispute settlement procedure to settle any dispute between a signatory country and an investor of the other signatory country"

In accordance to the 2013 BOI policy directive, a broad range of deregulation, in terms of reduced taxes and flexible legal paperwork regime was introduced for almost all sectors of the economy (See table 1 in annexure).

Bilateral Treaties:

Pakistan and China signed their first Bilateral Investment Treaty (BIT) in 1989 and entered into force in September 1990. Currently, the order of The Board of Investment Ordinance 2001 has mandated the Pakistan BOI to negotiate and conclude BITs.

4. FINDINGS:

Proposed advice from academic circle

This study is aimed to provide a specific yet comprehensive framework of legal laws, terms, rules provisions and/or regulations for foreign direct investment from the perspective of both China and of Pakistan. It points at how the infrastructure projects of CPECs transport networks can function throughout the region and reap benefits effectively by incorporating the needed soft-infrastructure, including important and relevant rules, regulations, clauses, terms, provisions and standards, any by effectively implementing and executing them[12].

Additionally, to make CPEC much more suitable for the region and effective in developing Pakistan, it needs to incorporate its vision and laws from local legislature and laws, terms, provisions, regulations, and standards which fir local requirements. What will aid this is a new focus on broader multi-faceted and coordination among stakeholders concerned. These include industries such as travel, communications, customs, immigration, and security authorities. With that a new focus on the capacity of national institutions has to be enhanced, from trust, continuity and long-term belief, so that effective implementation of these agreements takes place[13]. It's a requirement for relevant stakeholders to formulate a uniform or compatible standard of engagement for evolving the contradictions among the BIT and FTA between Pakistan and China.

Also, areas such as that of intellectual property rights and compensation rights needs to be made consistent in both documents; for which a plausible solution is allowing the BIT to dissolve and let the FTA to stand alone in unison to all laws[14].

Proposed advice from practical circle

There is a pertinent need to make full and effective use of all existing CPEC related institutions. The role of existing institutions and use of related legal and cooperation documents shall be given full access to information and investor ease of business[14]. Additionally, there is a need to establish a closer inter-governmental legal and commercial communication, linkage and cross-information spread mechanism and framework. It is also vital to strengthen and make robust the communication, coordination and inter-cooperation between the various committees and departments of the Committee, they must put forward work plans and a vision for further cooperation initiatives and dispute related matters, and finally formulate in a planned and systematic manner, detailed vision and inter-cooperation agreements that will be worked upon, executed and implemented jointly[14]. What seems to be different from the legal regime but can help ease of doing business is the use and provision of detailed institutional support in various business and commercial fields. Looking at the field of power and energy, joint efforts by both countries could help negotiate and sign different cooperation instruments on oil and gas pipe networks, grid infrastructure, power utilization and electricity preservation. Similarly, in the domain of transportation, similar understandings could be made to help and attract investments and as early as possible, foreign investment and financing plans, work on related legal provisions and repayment regimes could commence. Finally, there is a need to establish a regional policy system which prompts the construction and operation of the many CPEC related projects and plans. It should monitor all what the Pakistani side introduces, from specific policies on the taxation regime, land, workforce employment, customs clearance and cross-border use of RMB[14]. Added mandate of providing targeted technical training and cooperation to relevant stakeholders will make the system more effective. The training of Pakistani technical staffs should be strengthened, aiding the rule of law, information spread and the speed of the construction and maintenance of major projects in the fields of transportation, energy and industry and agriculture.

5. Conclusion

Our assessment began from a critical review of the very trade laws upon the CPEC is founded, and with crucial analysis from practical and academic circles, we find significant short comings within the legal regime which have been a catalyst for reduced ease of doing business. We found that Pakistan has yet to evolve its legal structure to modern standards. We have outlined major recommendations based on a comparative policy analysis, the key being massive introduction of capacity building measures, trust, credibility and transparency in the system. Pakistan has limited resources and has done well to at least being a notion of policy changes in recent legislation. The study explains how reforms would work well in areas such as taxation, bureaucratic tapes, court procedures and property laws, however, where the BIT and FTA stand and broad principles of engagement; new plans and laws need to be drown from the top-down and local legislative bodies must play a key role. In such a way the true aspirations of the people of Pakistan and crucial reform of admirative machinery would make ease of business all the more accessible in Pakistan.

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I. ANNEXURE

Policy Parameters	Manufacturing Sector	Non -Manufacturing Sectors		
		Agriculture	Infrastructure & Social	Services including IT & Telecom Services
Govt. Permission	Not required except 4 specified industries *	Not required except specific licenses from concerned agencies.		
Remittance of capital, profits, dividends, etc.	Allowed	Allowed	Allowed	Allowed
Upper Limit of foreign equity allowed	100%	100%	100%	100%
Customs duty on import of PME	5%	0%	5%	0-5%
Tax relief (IDA, % of PME cost)	25%	25%	25%	25%
Royalty & Technical Fee	No restriction for payment of royalty & technical fee.	Allowed as per guidelines - Initial lump-sum upto $100,000 - Max Rate 5% of net sales - Initial period 5 years		

Figure 1: Current Regulation Parameters of the BOI (https://invest.gov.pk/investment-regime)