KCS Country Risk & Threat Advisory

KCS Group Europe
Risk & Threat Advisory paper

Political Risk Advisory Briefing: Pakistan
April 2018

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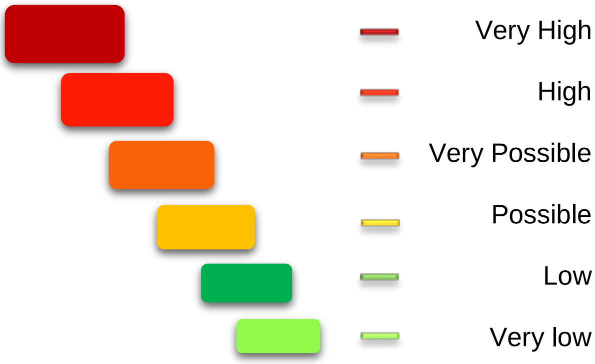
	Country:	Pakistan
	Population:	204,924,861
	Source:	CIA World Factbook

Pakistan has a GAD rating of 4

6	**Very High**	It will happen.
5	**High**	This could very well occur in the short term.
4	**Very Possible**	There is a likelihood of this happening.
3	**Possible**	This has 50:50 chance of occurring.
2	**Low**	Little chance of occurring.
1	**Very Low**	Unlikely to occur.



Politics

Pakistan's Prime Minister is somewhat upset at having to go through a routine security check on a recent visit to the US. Even their media is up in arms over this indignity. No doubt he will be happier facing the general elections on 15th July 2018.

The current party in power is the Pakistan Muslim League (PML), led previously by Nawaz Sharif, the former Prime Minister, who was recently removed from office on corruption allegations. It was the Panama Papers that sparked the original suspicions that led to his disqualification from political office; the investigation is however, still ongoing.

Shahid Khaqan Abbasi was nominated as PM for the remainder of the term. Regardless, rather incestuously Shehbaz Sharif, Nawaz's brother, has been put forward to lead the party in the forthcoming elections.

The other opposition parties are the Pakistan Tehreek-e-Insaf (PTI) guided by Imran Khan and the Pakistan People's Party (PPP). It is however, highly unlikely that any of these two will win the elections; power will without doubt remain in the hands of the PML and the Sharifs.

In the opinion poll from November 2017 it reported 34% in favour of the PML and 26% for the PTI. Nawaz's daughter, Maryam, has in the meantime been campaigning around the country defending her father's reputation. Although he is banned from running, KCS is of the view that his party is expected to win again but not with the same support it had in 2013, as a consequence of recent events.

There is also the suspicion that the elections could be fixed, as during the recent Senate elections votes were bought. However, the situation remains unpredictable. The decisions that the current government will take in the next few months, especially in regards to the economic situation, could be determinant.

Economy

Pakistan's macroeconomic performance has been increasing since 2016, accelerating even more in mid-2017, which should be maintained throughout 2018. The economy is growing at its fastest pace in a decade, 5.3%, and it is projected to grow, however it will not exceed 6% in 2018. Exports of textile and agricultural and manufactured products are not by themselves sufficient, hence in his desperate run to resuscitate the economy the government increased taxes in October, despite being the country heavily reliant on oil and goods imports.

The China-Pakistan Economic Corridor (CPEC) not only will boost the two countries' economies but it will also ease general commerce with Asia. The $60 billion invested will be devoted to the construction of new energy power plants, modern infrastructures and transportation networks that will generate new trade opportunities as well as create new economic zones.

Corruption

Pakistan did not achieve any progress on corruption. For two years in a row the country scored 32 in the Transparency International's Corruption Perception Index 2017 that positioned it 117th out of 180 countries.

Corruption is part of Pakistan's culture, it penetrates all strata of society reaching the higher ends, government and law enforcement. A clear example is the Sharif family dominating the political scene; Maryam takes care of the campaign and Nawaz Sharif's brother is now head of the party. Nepotism and cronyism are accepted as common practices and deeply embedded in the country.

The recent Senate elections have also seen some illegalities committed; members have been accused of selling their votes to the opposition party. Bribery is the norm, not only in politics but also in the day-to-day service sector, such as health and education, to the extreme level that services are denied unless a price is paid.

Therefore, corruption, in all its forms, can represent an obstacle especially for someone who is not used to such practices and it should be carefully evaluated when prospecting to invest in Pakistan.

Business environment

Fast-growing with a young population, Pakistan represents a great opportunity for business, but some challenges should not be underestimated as corruption and lack of transparent business regulations could have devastating repercussions.

The government had actuated an action plan in order to promote FDIs and improve the effectiveness of the regulatory framework already in place hoping to climb the rank published by the World Bank Doing Business Report 2017 which positioned it 147th out of 190. The first step was the introduction of laws which facilitated the bureaucratic processes of setting up businesses.

The political uncertainty and corruption tend to influence foreign investors' perception of business in the country, but the situation is better than it seems; in fact, some countries have realized Pakistan's potential.

China is the main investor amounting to 40% of FDI. The CPEC is playing a significant role calling for the involvement of multiple companies, such as the Sichuan Energy Investment Group responsible for the Ashkot hydropower project and the M/s China State Construction Engineering Corporation building the Karachi-Peshawar motorway.

China's investment in the project does not include exclusive deals or benefits, as it could be mistakenly assumed, and opportunities are equal to anyone thinking of investing. Qatari and Saudi investors are sponsoring electric power projects; similarly, Afghanistan might get involved as well.

Saudi Arabia is another important investor. In fact, both parties affirmed their commitment to facilitate trade relations and the Pak-Saudi Joint Business Council will become active in the next few months.

China and Saudi Arabia have replaced the US as biggest investors in Pakistan; other countries are also evaluating the country's potential.

A French delegation of entrepreneurs, MEDEF, including Renault and the Suez Group, is exploring various possibilities in the automobile, oil and gas, energy and water sectors. The Anglo-Dutch company Unilever has just announced that it will be investing $120m in the next two years for its manufacturing. Although lower than neighbouring India, Pakistan's attractiveness for investment is high.

Foreign affairs

The Pakistan-US relationship is currently on hold. On the accuses of providing safe havens to terrorists and having no control over the Afghanistan border, US military aid has drastically declined, leaving Pakistan in search of other allies. It still is unclear whether this decision will have an effect on US companies in Pakistan, but given that American interest is poor the effect of the political move will be very little.

The US is currently siding with India, as the two seem to share common interests such as punishing Pakistan for supporting terrorists. Moreover, the US has imposed sanctions on seven Pakistani companies suspected to be involved in nuclear activities. The direction the US is taking appears to be part of the wider plan against Pakistan and clearly in support of India.

India is Pakistan's long time enemy and relations remain almost non-existent, reaching what has been defined as the lowest point in four years. The contested border between the two countries, the Line of Control (LoC), continues to be under attack with drones shot down and soldiers and civilians killed. The situation will not be resolved in the near future and it is very likely to persist, as the nature of the problem is rooted in history. The dispute over Kashmir was defined by the UN High Commissioner for Human Rights Zeid Al-Hussein an urgent humanitarian crisis, like Syria and Myanmar.

On the business side the India-Pakistan rivalry is not perceived as equally devastating; India is importing cotton from Pakistan and Nestle's pet food branch Purina has just settled in both countries, suggesting that conducting operations in one country does not cut out opportunities in the other.

Given the recent disputes with the US, Pakistan is left to the ultimate available partner, Russia. Russia-Pakistan interests are actually more aligned than they appear to be. An energy deal has already started introducing the Russian Gazprom as supplier of LNG. Additionally, as both states are concerned about terrorists' presence in Afghanistan they are conducting joint military exercises and will continue to train.

China also fell for Pakistan's attractiveness. Although it is not much concerned about terrorism as the other 'allies', it is in its interest to maintain a good relationship with Pakistan in order to expand its business horizons.

Terrorism

The US accused Pakistan of supporting terrorists, providing them with safe havens along its borders, and in doing so it influenced the Financial Action Task Force (FATF) that decided to put Pakistan back on the grey list in June.

Appearing in the FATF watch list does not impose direct legal implications, but it can have serious repercussions on the economy and the country's reputation. Being labelled as a country financing terrorism would potentially scare investors and financial institutions, with banks refusing to conduct transactions with Pakistani institutions and eventually pulling out. The decline of foreign currency inflow will be reflected on the large account deficit of the country.

The old alliances have now shifted. While the US may be turning its back on Pakistan, China sees it as an opportunity for finance and investment and Russia views the country as a potential ally in the fight against terror. These are not alliances that may be palatable to the West, but the outlook for Pakistan, from a position of self-interest, is one of cautious improvement.

APPENDIX

GREY AREA DYNAMICS

Over the years, KCS has made it their business to find workable solutions to impossible problems. To do this, KCS has sought to establish clearly the intelligence gap between perception and reality.

In today's market where terrorism, organised crime, cybercrime and government sponsored cyber espionage and war appear to confront us daily, we need reliable tools to identify the risks well in advance. It was for these reasons that KCS created and developed the analysis of risk by Grey Area Dynamics or GAD's, as they are often referred.

GAD's are all the risks, weakness and threats that will, at one time or another, interfere, disrupt or at worst close down businesses. In the projects and work in which KCS have been involved in all over the world, it has been evident that the GAD's identified, can and do kill. This method of risk assessment and measurement goes well beyond standard due diligence and is a collective description of factors, which can be passive and non-passive, legal and illegal. Because GAD's are difficult to quantify or assess from a purely economic viewpoint, these considerations do not normally feature in most credit ratings, investment and banking reports, which focus only on sovereign risk.

The main categories of Grey Area Dynamics usually encountered are:

Passive/Legal

- Language & Dialects
- Local Customs & Traditions
- Local Staff – motivation and training
- Tribalism and Integration
- Cultural & Local sentiment
- Regulations, Taxes and Duties
- Currency & Capital exposure – payment methods and banking practice
- Environmental Hazards
- Pressure Groups
- Media Relations

Non-Passive/Legal

- Industrial & Labour Relations
- Absence or effectiveness of Legal Safeguards
- Government Policy and Nationalisation
- Overt and disguised/beneficial ownership
- Bureaucracy and Local Government
- Public or Media hostility

Passive/Illegal

- Bribery & Corruption
- Vested Interests and Cronyism
- Patronage
- Product diversion
- Parallel Trading
- Hidden Barriers to entry

Non-Passive/Illegal

- Counterfeit & Fraud
- Pilferage
- Unfair Market Competition
- Product Piracy
- Ethics and Corporate Espionage
- Organised Crime
- Threats to physical assets
- Kidnap & Extortion
- Religious Extremism
- Terrorism
- Civil Unrest
- Product Contamination

For a risk assessment to be thorough, it must encompass the potential for a broad array of economic, political and business situations that might affect a business venture. Evaluations limited just to political issues or financial factors may be completely misleading.

The degree of severity of a risk portfolio will also depend on the origin of the investing entity; for example, European companies often face different risk profiles to American corporations considering the same investment opportunity.

Grey Area Dynamics pose a challenge of diagnosis[1]. The key to avoiding problems before they occur, or solving them after they have begun to take a toll on performance, lies in their early identification and evaluation. Ignoring the impact of GAD's can be a costly business.

[1] KCS Group Europe won the European Service Provider of the Year, 1999-2000 at the European Risk Management Awards magazine International Risk Management for their work on GAD's. In 2004, the company won an award for Product of the Year from StrategicRisk.