January 6, 2011

The Honorable Thomas R. Nides
Deputy Secretary of State for Management and Resources
U.S Department of State
2201 C Street NW
Washington, DC 20520

Subject: Open letter #6, U.S. support for Pakistan's private sector[1]

Dear Secretary Nides:

This correspondence marks the sixth in our series of open letters to officials of the Obama Administration. The purpose of these open letters is to provide constructive commentary and practical recommendations on the deployment of Kerry-Lugar-Berman funds and more broadly on U.S. trade, investment and other policies that can contribute to long-term growth and development in Pakistan. The letters are the outcome of consultations with a Center for Global Development study group made up of policy experts and scholars on economic development, Pakistan, and U.S. foreign affairs. The overall aim of the group is to encourage increased attention by the United States to long-term growth, human development, and democracy in Pakistan as the best investments in a more stable partner for the United States. A more explicit and visible focus on those long-term goals in the interests of both Americans and the people of Pakistan seems to me and members of the study group more vital today than ever, if only to help reset the nature of official U.S.-Pakistan relations given recent setbacks.

Our prior letters were addressed to Ambassador Holbrooke in his role as Special Representative for Afghanistan and Pakistan. I am addressing this letter to you rather than to Ambassador Grossman, as I have the impression that you have taken ownership of the development aspects of the Pakistan portfolio at the State Department. Having said that, we are concerned—indeed alarmed—that at this late date in the Obama Administration's first term, responsibility and accountability for the development portfolio in Pakistan remains unclear. We are convinced that the resulting uncertainty and lack of sustained mission and direction is handicapping the administration's efforts. As we have recommended in the past, we urge you and Secretary Clinton to put one person in charge of the development program in Washington and Islamabad; this is the only way to ensure that the United

[1] This open letter will be published on the Center for Global Development website (www.cgdev.org) and disseminated to relevant officials in the administration and Congress.

States speaks with one voice when it comes to our civilian partnership with Pakistan. As with past letters, I am also copying this letter to other senior administration officials.

Since the release of our June 2011 report[2] (which I was pleased to discuss with you at the time), we have remained engaged with many colleagues in the Obama Administration and in Congress (as well as in Pakistan) in an effort to find openings for the United States to make headway on the five major recommendations of that report. In this open letter, I am conveying the recommendations that emerged from the most recent meeting of our study group, in which we focused on what U.S. policies would be most effective in expanding economic opportunities and creating jobs via Pakistan's private sector. I recognize that you and your team have been working on a variety of policy initiatives to expand economic opportunity for ordinary Pakistanis. Indeed, your November 2011 report recognizes that "greater emphasis on economic growth that brings economic opportunity to the rapidly growing population is key to Pakistan's future success and stability."[3]

Our study group discussed and agreed on three specific recommendations on how the U.S. approach to private sector development could be strengthened.

1. **Expand market access to Pakistani goods, but drop attempts to create Reconstruction Opportunity Zones (ROZs).**[4] As you know, the bipartisan ROZ legislation introduced in the previous Congress, and supported by the Obama Administration, would allow for certain textile and apparel items to receive duty-free access to U.S. markets if they are produced in "special zones" within Pakistan. Although the legislation has not been introduced in the current Congress, we understand that establishing ROZs remains a priority for the administration. However, we believe that this half-measure is unlikely to achieve significant gains for Pakistan's economy and could in fact be counter-productive. First, it will not be sufficient to spur Pakistan's economy. Geographic and product restrictions have been defined in such a way as to severely limit the amount of additional investment and job creation that might be triggered. Second, the legislation has an obvious disadvantage in terms of the signal it sends to the people of Pakistan. By focusing largely on insecure areas, ROZs risk reinforcing the perception that the U.S. is interested in Pakistan solely for security reasons. This is the case even given the extension of the eligible areas to cover flood-affected districts that has been discussed by the administration. Instead, we urge you to work with Congress to cut tariffs across the board for U.S. imports from Pakistan. An analysis by CGD's Kimberly Ann Elliott shows that providing duty-free, quota-free access to goods from Pakistan would have minimal impacts on the U.S.

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[2] Center for Global Development, *Beyond Bullets and Bombs: Fixing the U.S. Approach to Development in Pakistan* (2011). Available at: http://www.cgdev.org/content/publications/detail/1425136.

[3] Office of the Special Representative for Afghanistan and Pakistan, *Status Report: Afghanistan and Pakistan Civilian Engagement* (November 2011).

[4] A detailed analysis of the CGD analysis on U.S. trade policy with Pakistan can be found in Kimberly Ann Elliott, "Getting Real on Trade with Pakistan: Duty-Free Market Access as Development Policy," CGD Working Paper 241. A summary of the main arguments can be found here: http://www.cgdev.org/content/publications/detail/1424056/.

economy and jobs. Along with strengthening the US-Pakistan bilateral trade relationship, we recommend that you reinforce any internal efforts underway to strengthen regional trade between Pakistan and its neighbors—in particular, India. The recent decision by the Government of Pakistan to grant Most Favored Nation (MFN) status to India provides a unique opportunity to work with both Indian and Pakistani business interests that are advocating for the normalization of trade relations. Progress towards this goal would yield huge dividends to the Pakistani economy and contribute to regional stability.

2. **Task OPIC, in partnership with USAID, with establishing a new facility for small business lending in Pakistan.** We are aware that Congress did not provide an authorization of $60 million for the creation of a Pakistani-American Enterprise Fund in their "megabus" appropriation package, as the draft FY2010 Senate Foreign Operations had explicitly done. Fortunately, enterprise funds are not the only tool for encouraging business development in Pakistan, nor does the Administration need any specific Congressional authorization to take action. A new OPIC fund focused on Pakistan could guarantee loans by local banks to SMEs, increasing the availability of credit to this vital sector. Small and medium enterprises in Pakistan create jobs and contribute to the vibrancy of local economies, yet they are constrained in the ability to access credit. Although Pakistan has a robust banking sector, the current climate (in which banks can do well at low risk by lending to the government) provides no incentives for banks to expand their lending operations in the SME sector. A successful push to stimulate investment in SMEs will likely need to pair investment capital with technical assistance.[5] Building off previous joint efforts in Palestine, Egypt and Jordan, OPIC and USAID could establish a cooperative agreement under which the U.S. government would provide financing and technical assistance to Pakistani SMEs.[6] USAID, for its part, could provide technical assistance to banks—to enhance their ability to evaluate the creditworthiness of small firms—and to borrowers—to help develop their capacity to apply for loans and develop credible business plans. As it has done in the past, USAID could also cover the operating expenses of local implementing partners. Because of OPIC's credit subsidy requirements (and the limited nature of funds appropriated for this purpose), USAID could also be called on to provide grant financing to OPIC, if necessary. Because OPIC and USAID have engaged in similar partnerships together, there is a clear roadmap for making this happen.

3. **Finally, we encourage the United States to publicly signal its commitment of resources—diplomatic, financial and technical—to get the proposed Diamer-Basha dam project off the**

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[5] Indeed, one recent think tank report highlights the need for the U.S. government to better integrate its investment capital and technical assistance capacities. See Center for Strategic and International Studies, *Sharing Risks in a World of Dangers and Opportunities*, Report of the CSIS Project on U.S. Leadership in Development, December 2011.

[6] An alternative approach would be for the U.S. government to encourage the creation of an SME equity fund and provide support to this fund through an OPIC credit enhancement and a USAID technical assistance window to support SME development. Such a fund would leverage US money to attract other funds from private groups in Pakistan, which could bring in additional capital.

ground. I understand that there is a great deal of support within the U.S. government for this project and that potential donors are awaiting a clear signal from the Asian Development Bank—including critical member countries, such as India—once it completes its due diligence report. Nonetheless, I would like to see the U.S. government be more forward-leaning on this issue. Although we believe there is reason to worry that financial investments in the energy sector could blunt the pressure for sectoral reform, we do believe that investing in a large hydropower project could have several second and third-order benefits beyond the obvious enhancements to the country's energy production. First, because it will take as much as ten years to produce energy, leadership from the United States in moving the project forward would signal America's long-term commitment to the Pakistani people. Second, such a project would be a highly visible symbol of U.S. assistance, particularly in a sector plagued by shortages that tangibly affect the lives of millions of Pakistani citizens on a daily basis (indeed, many Pakistanis still harken back to the United States' assistance in building the Mangla and Tarbela dams). Third, a clear and visible U.S. commitment (along with that of the ADB) to Diamer-Basha would send a key signal to potential private sector investors. Of course, one would expect that when electricity is added to the grid in the medium to long run, this too would have positive externalities for the investment climate.

Your November 2011 status report identifies trade, investment and infrastructure investment as key components of the overall U.S. civilian assistance strategy in Pakistan. We applaud your efforts in trying to move from ideas to action and believe the suggestions enumerated above will serve to strengthen the overall policy. I hope this letter is useful to you and your colleagues, and that it can serve as the basis for future discussions. I welcome any comments from you and your team.

Sincerely,

Nancy Birdsall

Nancy Birdsall
President, Center for Global Development

Attachment: CGD Study Group on a U.S. Development Strategy in Pakistan

Cc: Dr. Rajiv Shah, U.S. Agency for International Development
Dr. Andrew B. Sisson, U.S. Agency for International Development
Ambassador Marc Grossman, U.S. Department of State
Ambassador Cameron Munter, U.S. Department of State
Mr. Richard Albright, U.S. Department of State
Ms. Elizabeth Littlefield, Overseas Private Investment Corporation
Mr. Neal S. Wolin, U.S. Department of Treasury

CGD STUDY GROUP ON A U.S. DEVELOPMENT STRATEGY IN PAKISTAN*

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** Study group members serve in their individual capacity; their affiliations are shown for identification purposes only. While the open letter draws heavily on the views expressed in the working group meeting, individual members do not necessarily endorse all policy recommendations contained in the open letter.*