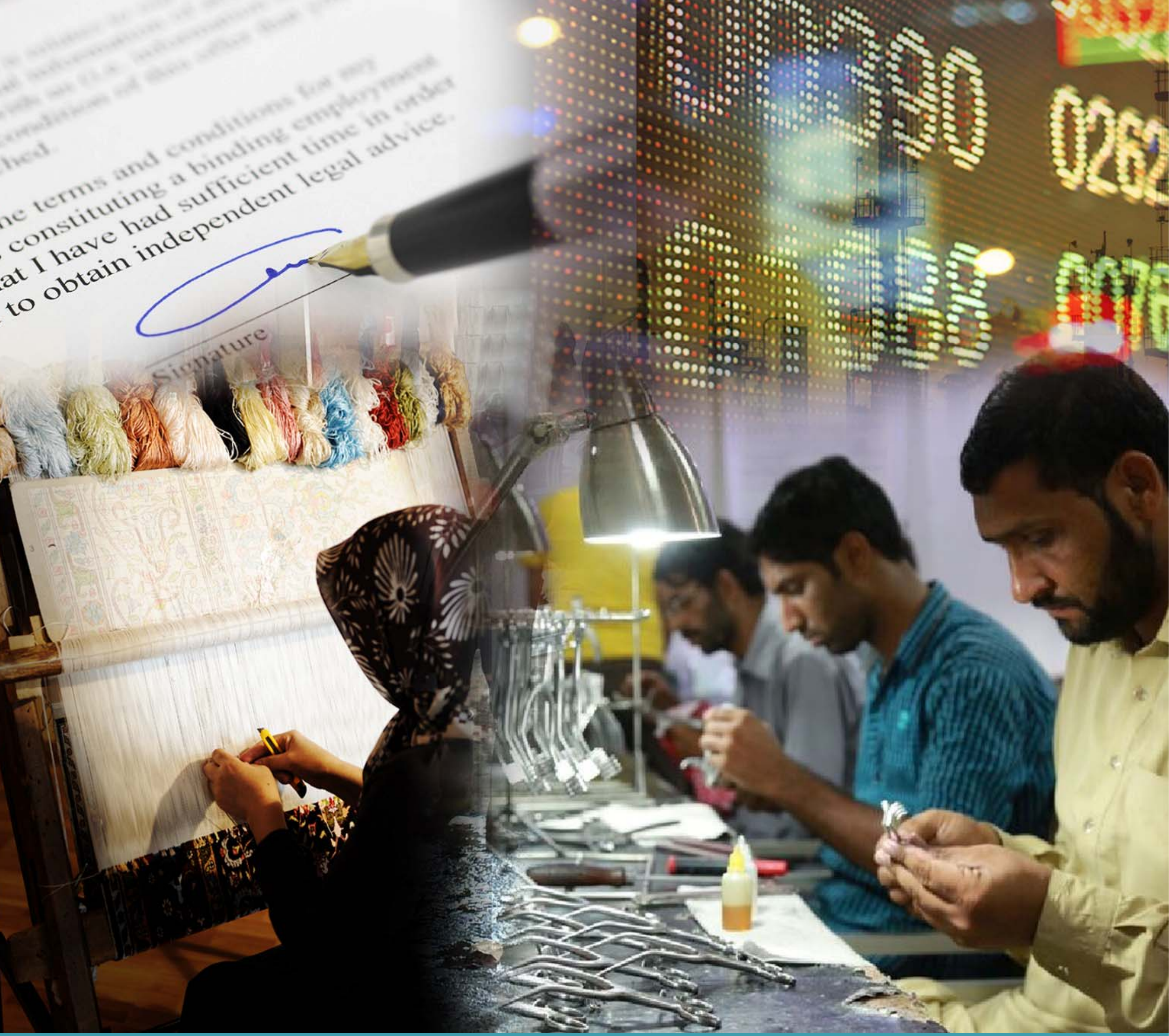

Business Environment Reform Facility

Diagnostic and Research study on policy reforms for Punjab's priority business sectors

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Business Environment Reform Facility

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Department for International Development

About Business Environment Reform Facility (BERF)

BERF is funded by the UK Department for International Development (DFID) under the Business Environment for Economic Development (BEED) Programme. BERF is a central facility responding to demand from the DFID's priority Country Offices and stakeholders to initiate, improve and scale up business environment reform programmes. BERF is managed by a consortium led by KPMG LLP. The programme started in January 2016 and will finish in January 2019.

We provide expert advice, analysis of lessons learned, policy research about what works and what doesn't and develop innovative new approaches to involving businesses and consumers in investment climate reform.

BERF has a strong emphasis on strengthening the Business Environment for women and girls, as well as for young adults more generally. It is also aiming to improve the relationship between business and the physical environment including where relevant through linkage to climate change analysis. BERF recognises the need for appropriate political economy analysis in order to underpin business environment reform processes and interventions.

About this Report

Research for this study was conducted by Jayyad Malik, Usman Khan, Nazish Afraz, Hina Shaikh and Dan Aylward between July and November 2016.

Department for International Development

Table of Contents

About Business Environment Reform Facility (BERF) ii

About this Report ii

1. Executive Summary 1

1.1 Introduction 1

1.2 Cross Cutting BER Constraints 2

1.3 Garments 7

1.4 Automotive 9

1.5 Footwear 10

1.6 Agriculture 11

1.7 Livestock 12

1.8 Conclusions 16

2. Introduction and Context 17

2.1 Background 17

2.2 Purpose, approach and methodology 18

2.3 Sector Focus 21

2.4 Structure of the Report 22

2.5 Limitations 23

3. Cross Cutting BER Constraints 24

3.1 Business Licensing & Registrations Procedures 24

3.2 Tax Policies and Administration 26

3.3 Access to Finance 28

3.4 Labour Laws and Administration 29

3.5 Overall Quality of Regulatory Governance 30

3.6 Land titles, Registration and Administration 32

3.7 Access to Commercial Courts and Alternative Dispute-Resolution Mechanisms 33

3.8 Public-private Dialogue Processes 34
3.9 Access to Market Information 35

4. Cross Cutting Recommendations 36

4.1 Business Registration and Licensing Procedures 36
4.2 Tax Policies & Administration 37
4.3 Labour Laws and Administration 39
4.4 Access to Finance 41
4.5 Overall Quality and Governance 42
4.6 Land titles, Registration and Administration 44
4.7 Access to Commercial Courts and to ADRM 45
4.8 Public-private Dialogue 46
4.9 Access to Market Information 47

5. Garments Overview 51

5.2 Garments Diagnostic Section 56
5.3 Review of regional/international best practices 62
5.4 Recommendations 67

6. Automotive 71

6.1 Automotive Overview 71
6.2 Automotive Diagnostic Section 77
6.3 Review of Regional/International Best Practices 82
6.4 Recommendations 85

7. Footwear 88

7.1 Footwear Overview 88
7.2 Footwear Diagnostic Section 91
7.3 Review of Regional/International Best Practices 96
7.4 Recommendations 101

8. Agriculture **105**
8.1 Agriculture Overview 105
8.2 Agriculture Diagnostic Section 108
8.3 Review of regional/international best practices 112
8.4 Recommendations 115
9. Livestock **118**
9.1 Livestock Overview 118
9.2 Livestock Diagnostic Section 121
9.3 Review of Regional/International Best Practices 127
9.4 Recommendations 130
10. Conclusions **133**

Abbreviations

ADP	Automotive Development Policy
ADRM	Alternate Dispute Resolution Mechanism
BER	Business Environment Reform
BERF	Business Environment Reform Facility
BOP	Bank of Punjab
CPEC	China-Pakistan Economic Corridor
DCED	Donor Committee on Economic Development
DFID	Department for International Development
DTRE	Duty and Tax Remission Scheme
E&T	Excise and Taxation
EOBI	Employees Old-Age Benefit Institute
EPA	Environmental Protection Agency
EPD	Environmental Protection Department
EPZ	Export processing zones
FBR	Federal Board of Revenue
FSSAI	Food Safety and Standards Authority of India
GoPb	Government of Punjab
ICRU	Investment Climate Reform Unit
IFC	International Finance Corporation
ILO	International Labour Organisation
IPO	Intellectual Property Organisation
LCCI	Lahore Chamber of Commerce and Industries
LDA	Lahore Development Authority
LRMIS	Land Record Management Information Systems
MTI	Ministry of Textile Industry
OEM	Original Equipment Manufacturers
PAAPAM	Pakistan Association of Automotive Parts & Accessories Manufacturers
PBIT	Punjab Board of Investment & Trade
PESSI	Punjab Employees Social Security Institute
PFA	Punjab Food Authority
PFMA	Pakistan Footwear Manufacturing Association
PGS	Punjab Growth Strategy

PHMEA	Pakistan Hosiery Manufacturers & Exporters Association
PPD	Public private dialogue
PRA	Punjab Revenue Authority
PRGMEA	Pakistan Readymade Garments Manufacturers & Exporters Association
PSQCA	Pakistan Standards and Quality Control Authority
SECP	Securities and Exchange Commission of Pakistan
SME	Small and Medium Enterprise
SMEDA	Small and Medium Enterprise Development Authority
TDAP	Trade Development Authority of Pakistan
TMA	Town Municipal Authority
WHO	World Health Organisation

1. Executive Summary

1.1 Introduction

1.1.1 Background

The Punjab Government is targeting growth of 8% by 2018, which will be necessary to absorb the one million people entering the workforce every year. In order to achieve this, it is aiming to facilitate significantly increased private sector investment. Business in Pakistan has been constrained by weaknesses in the investment climate. Between 2006 and 2017, Pakistan has fallen in the World Bank's 'Doing Business' rankings, from 60 out of 155 countries to 144 out of 190 countries.

The recent 18th Constitutional Amendment devolved responsibility for four out of ten of the Doing Business indicators to the provincial government. The International Finance Corporation (IFC) has recently established the Investment Climate Reform Unit in the Planning and Development Department.

1.1.2 Purpose

The purpose of this research is to identify the binding constraints within the business environment in selected priority sectors identified by the government on the basis of their economic significance: garments, automotive, footwear, agriculture and livestock.

1.1.3 Approach

The Donor Committee for Enterprise Development's (DCED) business environment reform (BER) framework has been adopted. This identifies nine BER functions:

- Simplifying business registration and licensing procedures
- Improving tax policies and administration
- Enabling better access to finance
- Improving labour laws and administration
- Improving overall quality of regulatory governance
- Improving land titles registers and administration
- Simplifying and speeding up access to commercial courts and to alternative dispute resolution mechanisms
- Broadening public, private dialogue process with a particular focus on including informal operations

- Improving access to market information.

1.1.4 Methodology

Interviews were conducted with (between 7 and 11) businesses and business member organisations within each sector to identify which aspects of the business environment were the biggest impediments to growth, and which of the nine BER areas should be prioritised.

Case studies of other countries which have successfully addressed these constraints or which have seen strong growth in the priority sectors have been developed to identify best practice.

The interviews and case studies have been used to develop policy recommendations for the Punjab Government.

1.2 Cross Cutting BER Constraints

1.2.1 Business Licensing & Registrations Procedures

Several steps are required to register a company in Punjab. Even though most government departments have automated systems, they fail to share data with each other, resulting in duplication of effort by businesses. Most of these steps implicitly assume that firms have already been operating in the informal sector. Small firms are discouraged from registering by the large reporting and tax burden.

Sales tax registration with the Securities and Exchange Commission of Pakistan (SECP) has recently been automated online. Although this has accelerated the process, lawyers are still required and delays are often still incurred when finalising company names.

Companies must then register with numerous government departments for tax purposes. Sales tax registration with the Federal Board of Revenue (FBR) is particularly complicated, and new firms seldom have the required information on suppliers and customers to prove they are genuine. Digitisation of the process has also increased reliance on costly tax lawyers.

Various other clearances and permits are required, including from the Town Municipal Authority and Lahore Development Authority (for buildings), the Intellectual Property Organisation and the Environment Protection Agency. These are often time consuming, require informal payments or can be counterfeited.

We **recommend** that:

- Punjab Board of Investment & Trade (PBIT) advocate for SECP and the Intellectual Property Organisation to publish databases of company names, patents and logos online.
- A helpline should be initiated to facilitate registration. In the longer term, a one window facility to support registration, tax, monitoring and compliance should be established.
- In the longer run, registration processes should be simplified, including through the use of a centralised database of information that is shared between different departments.

1.2.2 Tax policies and administration

All aspects of the tax system, including policy, administration and institutional capacity, constrain businesses.

Policy is unclear, complex and disconnected from wider policy objectives. Tax policy is subject to sudden changes, particularly customs or regulatory duties, which can impact the financial feasibility of investments and require tax lawyers to be retained in order to keep abreast of changes.

Tax administration is hostile, with federal and provincial tax authorities focused on maximising revenues, without coordination, proper implementation of tax rules or consideration of the impact on businesses. Businesses face a duplication of taxes, particularly value added tax, by the FBR and Punjab Revenue Authority (PRA).

Tax officials retain discretion over amounts required to settle tax invoices. Claiming tax refunds resulting from over-taxation take a long time and tie up working capital. These issues are often resolved with informal payments.

Filing of tax returns is onerous and places a disproportionate burden on small businesses who are unable to hire tax lawyers and accountants.

We **recommend** that

- Provincial tax authorities state clearly on tax invoices the basis of calculation. New firms should be given an incubation period where they are exempt from non-revenue based taxes.
- In the medium to long term, a single tax collection agency should be established for provincial taxes to avoid duplication, under a single tax ID. The PRA should be made more transparent and business friendly, and applicable taxes published on their website.

- The Government of Punjab should also seek greater coordination with FBR and synchronise tax policy with wider policy objectives. Sales tax refunds should be expedited. Evaluation criteria for tax inspectors should be reviewed and changed to avoid unintended consequences of over taxation.

1.2.3 Access to finance

Small and Medium Enterprises (SMEs) struggle to access finance at affordable interest rates, typically paying KIBOR + 3 – 6%, whereas larger firms can secure rates of KIBOR + 1 – 1.25%. There are currently no specific SME financial products available. Business assets, such as stocks, letters of credit for export orders, confirmed orders and factory premises are often not accepted as collateral, and personal property must be used instead, or else firms rely on unleveraged personal savings.

We **recommend** that:

- The Bank of Punjab (BOP) facilitate alternatives to collateral to promote investment in capital and technology. Loans should be provided at preferential rates to selected industries, especially for SMEs, and linked to export performance. In the medium term, BOP should consider credit guarantee schemes, which are already used by more than half of countries worldwide.
- In the longer term, an electronic registry of moveable capital should be developed and credit bureaus should be strengthened to provide better information to lenders so they can reduce their risks.

1.2.4 Labour laws and administration

The Labour Department has a mandate to protect workers and avoid exploitation, but is not required to promote economic growth or employment creation.

The Labour Department enforces its mandate with reference to outdated laws, such as requirements to repaint factory walls every six months and to have metal bathroom fittings. These laws are often ambiguously worded, which make them ripe for extracting unofficial payments. Enforcement is generally seen as ineffective, with firms making informal payments to avoid inspections. Actual compliance is driven by demands from customers or business's own consideration for their workers.

Labour laws disproportionately affect SMEs, who lack the resources and influence to challenge improper penalties. Firms in industrial estates are less exposed to labour inspectors as industrial estate offices act as a deterrent.

Both India and Sri Lanka have taken steps to streamline physical inspections. India has created online interfaces to apply for licences and renewals, and created online checklists for inspectors and businesses to increase transparency. In Sri Lanka, multidisciplinary inspection teams undertake coordinated compliance checks in a single visit.

We **recommend** that:

- The Labour Department create a short labour code compliance booklet and checklist containing all application laws. The large number of labour laws need to be reviewed and streamlined to ensure that they do not hinder employment creation and that they can be effectively enforced. Labour policy should be consistent with wider objectives of economic growth and private sector development.
- In the medium term, we recommend that labour officials should only be able to approach businesses through an intermediary. Inspection requirements should be differentiated based on the risk profile of different industries. Low risk industries should be exempted from inspection, and third party certification should be sufficient for medium risk industries. An online system should be created with inspection reports uploaded by inspectors and viewable by businesses.

1.2.5 Overall quality of regulatory governance

The overall effectiveness of governance affects all aspects of doing business. Firms often deal with junior officers from a multitude of government departments, with large amounts of discretion.

Businesses reported particular difficulties with respect to No Objection Certificates from the Environmental Protection Department (resulting in informal payments); Structure Safety Certificates (with high fees paid to architects from certificates issued without visiting the site); and Dengue inspections (with informal payments made to avoid arrests after dubious findings of larvae).

In Croatia, most inspection processes have been consolidated into the State Inspectorate, reducing the number of units which conduct inspections from 110 to 49. In the UK, businesses enter into partnerships with a Primary Authority, which acts as the main channel for Government to determine compliance with different legislations.

We **recommend** that

- In the short term, the Department of Health should publish a list of approved Dengue spray companies who can issue certificates of compliance which exempt businesses from Dengue inspections. Software, such as AutoCAD, should be allowed for online verification of the compliance of building plans with building codes.

- In the longer term, efforts should be made to integrate inspections into a single inspection, in line with global best practice. Legislation should be developed which requires time bound delivery of services by Government to businesses, with punitive measures for failure to meet deadlines. This could cover labour, environment, land, construction permits, utility connections and provincial taxes.

1.2.6 Land titles, registration and administration

The computerisation of land titles in Punjab has resulted in a significant fall in informal payments: it is now quicker and cheaper to transfer land ownership. However, where changes are disputed a lack of sharing between courts, property registry office and tax office results in delays.

The establishment of new manufacturing units needs clearance from the Environmental Protection Agency, although the lack of proper land zoning makes this challenging.

We **recommend** that

- Land parcels are earmarked with the type of industry that can be established on them, with criteria and designation made available online. A model sale deed for property registration should be made available on the Land Record and Management Information System (LRMIS) website which should enable the use of e-stamps.
- In the longer term, a dedicated conflict resolution mechanism for land disputes should be established which bypasses the formal judicial system. Property registration, including payments and downloadable verification, should be digitalised. LRMIS should also make land mapping, including information on roads and water pipelines, available online, with the support of the Urban Unit.

1.2.7 Access to Commercial Courts and Alternative Dispute Resolution Mechanisms (ADRM)

Pakistan lacks commercial courts and business disputes are handled through ineffective, time consuming and costly judicial courts. Businesses generally try to avoid courts and seek out of court settlements, however, there is no legal backing for alternative dispute resolution mechanisms.

We **recommend** that :

- ADRM are developed for industrial estates and sector associations. In the longer term, a division under the High Court should be established for commercial cases, and a provincial policy covering out of court mediation introduced. A move towards electronic filing, summons and payment should also be established.

1.2.8 Public-private dialogue processes

Businesses reported a lack of formal, systematic dialogue processes during policy formulation. Although business member organisations are often invited to discussion forums, these were generally seen as ineffective. Consultations are seen as token and often occurring after decisions have been made. Businesses tend to rely on personal relations and networks.

BERF is already working with the Planning and Development Department and the Investment Climate Reform Unit to develop an online feedback mechanism to ensure that the private sector has better channels of communication with the public sector. This should be piloted in priority sectors.

1.2.9 Access to market information

Most firms do not consider the government as a reliable source for market information. The Trade Development Authority of Pakistan (TDAP) provides support to business to attend exhibitions and trade shows in existing export markets, although businesses are usually already aware of these. Other entities, such as the Small and Medium Enterprise Development Authority (SMEDA) and Punjab Small Industries Corporation (PSIC) have become redundant. Business associations are seen as bureaucratic and subject to capture by larger members.

We **recommend** that:

- PBIT should publish non-commercial data already collected by different government agencies on production, trade and export markets. PBIT and TDAP should commission market studies for priority sectors in non-traditional markets, including trade policies.

1.3 Garments

The textile industry accounts for 8.5% of Pakistan's GDP and 60% of national exports. Readymade garments are a particularly important sub-sector, accounting for 20% of national exports. Pakistan has a 1.2% share of the global trade in ready-made garments. Manufacturing of garments is labour intensive so has high employment impacts. Pakistan gained GSP plus status on 1 January 2014, although the impact on exports of garments has been limited.

Sales tax rebates are important to export orientated firms, but delays in sales tax registration and refunds lock up working capital. Without registration, firms cannot access support programmes provided by the Ministry of Textile Industry (MTI). Inputs have been temporarily zero-rated, although firms are unsure how long this will last. Manufacturers claimed that taxes were calculated on rigid and incorrect assumptions that reveal FBR's limited understanding of the sector. Certain inputs are subject to high or opaque import duties. Some outsourced processes result in duplicated taxes by FBR and PRA.

International buyers require strict compliance with environmental standards but manufacturers find the Punjab Environmental Protection Agency too slow and resort to more costly international certification. The sector lacks regulated quality standards.

Banks have recently increased risk ratings for the sector, making access to finance harder. Industry also believes that the minimum wage is too high.

Comparisons with successful garments exports show that inputs are either zero-rated (India, Bangladesh and Cambodia) or refunds are processed within strict time limits (Vietnam). Clustering industry has also shown to be effective, especially when combined with one-window facilities for government services. Special credit facilities have been provided to the sector in many countries, in addition to support in meeting international standards and environmental certification requirements.

We **recommend** that

- Companies be provided provisional registration with MTI whilst sales tax registration is pending. FBR should clarify how long zero-rating of textile inputs will last. To avoid harassment by labour inspectors, we recommend a fixed proportion of export revenues is accepted as EOBI and social security payments, similar to Bangladesh.
- In the medium term, efforts should be made to cluster industry in industrial parks, such as Quaid-e-Azam Apparel Park, and enhanced provision of government services should be available at these, including one window facilitation for registrations, simplified labour registration and payments, expedited land registration, quicker compliance with environmental standards and a focal point for PPD.
- In the longer term, efforts need to be made to make FBR's approach to taxing the sector fit for purpose. Quality standards also need to be introduced for the domestic market to ensure a level playing field and reduce certification costs for exporters. Finally, specific credit schemes tailored to the needs of the sector should be considered.

1.4 Automotive

The auto sector represents 16% of Pakistan's manufacturing output. In 2015, total automotive exports were US$45 million, of which US$17.4 million came from auto parts. Auto parts are the focus of this study, as the only other sub sector where Pakistan has reached significant scale is in the production of motorcycles, particularly 70 cc motorcycles, which have low export potential.

Auto parts produced in Pakistan are exported into niche or replacement markets. Pakistan's manufacturers only supply the domestic value chains – where they benefit from high tariff protection - of large original equipment manufacturers (OEMs) such as Toyota, Honda and Suzuki, but are not integrated into the OEM's global value chains. Progressing to supplying global value chains is an important next step for auto parts producers. Pakistan is well placed geographically, sharing a border with China, the world's largest vehicle manufacturer, and has good performance in logistics, however, price competitiveness and an unattractive business environment remain barriers to further growth.

As with other sectors, tax policy is seen as the biggest constraint. Aside from the general problems with the tax regime faced by all businesses, the historic alignment between tax incentives and growth objectives for the industry has fallen away and reversed, with high sales taxes discouraging vehicle purchases. Frequent ad hoc changes to customs and regulatory duties are particularly unhelpful for the industry given the high levels of capital investment required, as are wider changes to policy.

Unusually for a country with a domestic industry, the auto sector lacks a specific regulatory agency. Pakistan Standards and Quality Control Authority (PSQCA) has only specified standards for two wheelers although lacks capacity to properly enforce even these. The market is highly concentrated and there is a widespread perception of abuse of market power, but Competition Commission investigations into the sector have not been conclusive.

The auto parts association (PAPAAM) has proved useful for resolving disputes without resorting to the judicial courts. PAPAAM has also proved an effective coordination mechanism for PPD.

Case studies of regional competitors – China, Thailand and India – show that the auto sector has typically flourished thanks to tax breaks or subsidised credit for investments, technology and land acquisition, and reduced sales taxes in domestic markets. A regulatory framework setting out national standards is also vital.

Other countries with successful automotive sectors have specific regulatory and research bodies for the sector. In the absence of these, we **recommend** that:

- Tax policy decisions taken by FBR should better reflect the growth objectives for the sector. The Industries, Commerce and Investment Department should take a more active role in ensuring policy decisions do not negatively impact the sector.
- A set of national quality standards should also be a priority and something which the provincial government should advocate for. This could be achieved through membership of Working Party 29 of the World Forum for Harmonisation of Vehicle Regulations under the United Nations, as proposed by the auto policy, but a clear time-line is required. The Competition Commission of Pakistan should undertake regular market assessments, and broader regulatory and policy measures can be undertaken to support the industry, such as standards or incentives promoting environmentally friendly vehicles.

1.5 Footwear

Pakistan currently exports around US$117 million of footwear annually. Strong domestic demand for footwear has also supported a growing retail sector which, in turn, has attracted a number of international brands.

Once again, tax policy and administration was the biggest complaint for the sector. The application of incorrect tax penalties often results in delays to export orders. Import duties on raw materials have also weakened the competitiveness of Pakistan's footwear manufacturing sector and encouraged imports for the domestic market. A duty drawback scheme, initially useful for manufacturers, has become outdated and irrelevant.

Firms also noted several difficulties during business registration. They were often forced to register with Agriculture Market Committees despite using only *processed* leather. Protection of intellectual property, including brands, was weak despite digitisation of intellectual property registration. New businesses struggle to access credit and rely on equity rather than loans.

Labour laws and administration put the formal, exporting sector at a disadvantage to the informal sector, both in meeting the standards and dealing with labour inspections. Exporting firms also rely on expensive international certification as there are no national standards or certification bodies.

The Pakistan Footwear Manufacturing Association (PFMA) attends PPD processes but these are generally perceived as redundant and ineffective. PFMA has low membership, no authority to enforce ADRM decisions and no capacity or support to provide market research.

International case studies reveal that organising footwear manufacturers through clusters has improved competitiveness, especially when clusters are supported with one-window facilities for accessing devolved government services, including environmental compliance. Foreign investment has also played a major role alongside trade agreements.

We **recommend** that:

- Customs duties on imported raw materials and machinery are reviewed to ensure they are consistent with growth objectives for the sector. This should include the Duty Drawback Scheme.
- In the longer term, efforts should be made to organise the industry into clusters. A footwear industrial park should be established to help manufacturers overcome issues around land acquisition and registration, business registration and environmental compliance, and to enhance PPD. National quality standards should be introduced to ensure a level playing field between exporters and domestic orientated firms.

1.6 Agriculture

Agriculture contributed 21% to national GDP in 2014-15 and has been growing at almost 3% annually. Businesses from two key subsectors were interviewed for this report: horticulture – which generates 12% of agricultural GDP and is the largest category of agricultural trade, with US$650 million of horticulture exports – and agro-processing, which processes agricultural raw materials such as rice (almost US$2 billion of exports in 2015), sugar and oils.

Agricultural trading occurs at fruits and vegetables markets, which are overseen by Market Committees. Businesses were generally dissatisfied with the performance of these, with positions awarded for political reasons over merit, and market information provided by them was often inaccurate.

Businesses complained of a heavy regulatory burden, dealing with up to 25 different agencies, many of which require unofficial payments. Tax policy and administration was again the biggest issue, with tax liabilities often calculated on incorrect assumptions. SMEs noted relatively high transaction costs levied by banks for deposits and withdrawals, and a lack of access to credit because of volatility in prices.

Labour laws were generally bypassed by horticulture businesses by outsourcing human resourcing and contracting of day labourers to a contractor.

Systematic PPD is lacking in the sector; only larger businesses are consulted by government agencies in policy formulation. The Department of Agriculture did not recognise the growth of agribusinesses as part of its mandate, which it saw as supporting smallholder farmers to increase productivity.

We **recommend** that:

- A more systematic PPD mechanism is established between the Department of Agriculture and agribusiness. It should also seek to increase the supply of market collection and supply of data. The role of Market Committees should also be reviewed by Department of Agriculture to ensure they are fit for purpose.

1.7 Livestock

The livestock sector (a subsector of the broader agricultural sector) contributed 11.8% to national GDP in 2014-15, and grew by over 4% annually. This research is based on interviews with businesses from two important subsectors: dairy and poultry.

Tax policy was the biggest concern raised by the sector. Milk was recently changed from zero-rated to tax exempt, but delays in refunding taxes on inputs have tied up substantial amounts of working capital. Duties on imported machinery and delays in refunds have had a similar impact in the poultry sector. Increases to customs duties, aimed at discouraging imports, have increased production costs for products where there are insufficient or only low quality domestic substitutes for both the dairy (powdered milk) and poultry (soybeans) sectors.

Access to finance remains an issue, particularly in a sector dealing with perishable products.

Businesses face multiple and at times divergent sets of regulations from the (Federal) PSQCA, the Punjab Food Authority (PFA), and even Cantonment regulatory bodies. Environmental restrictions on locations of poultry premises are neither realistic nor effectively enforced. Conflicting regulations are applied by the PFA and District Coordinating Officers regarding milk chillers. Packaging rules reveal ignorance about the industry. Such unclear regulations are ripe for extortion and provide a competitive advantage to the informal sector, which is not subject to regulation or product safety and quality standards.

We **recommend** that

- A review of environmental and product standards is urgently undertaken to remove outdated regulations and ensure consistency in enforcement between different agencies.

- Systematic PPD mechanisms are developed to gradually replace unilateral lobbying efforts by the larger businesses. This will reduce the risk of counterproductive policies being implemented, and determine needs and enhance access to market information.
- In the longer term more effective enforcement mechanisms need to be developed for environmental regulations. Sector specific finance schemes should be considered which recognise the peculiarities of the sector. A review of both tax policies and administration that hinder the sector should be undertaken to ensure they are consistent with the growth objectives of the government.

Table 1.1 Summary of findings

Sector	Size of sector	Biggest Constraints	Best Practice	Recommendations
Garments	$4.5 billion exports in 2015: 20% of Pakistan's total exports.	▪ Tax policy: sales tax rebates, duplication of taxes and import duties. ▪ Compliance with environmental standards by international buyers. ▪ Lack of quality standards. ▪ Increased risk ratings.	▪ India, Bangladesh, Cambodia (zero ratings), Vietnam (refunds processed quickly). ▪ Bangladesh: simplified social security payments	▪ Provisional registration with MTI permitted whilst sales tax registration pending. ▪ Clarity over duration of zero rating and improvements to FBR approach to taxing the sector. ▪ Proportion of revenues accepted as EOBI and social security ▪ Clustering in industrial parks such as Quaid-e-Azam Apprel Park, including one window facilitation of Government services. ▪ Quality standards for domestic market. ▪ Credit schemes for the sector.
Auto parts	$17.4 million of exports in 2015.	▪ Tax policy: high sales taxes and unpredictable customs duties on inputs. ▪ Lack of quality standards.	▪ China, Thailand and India: supportive tax policies. ▪ National standards.	▪ Introduction of national standards. ▪ Regular market assessments by Competition Commission. ▪ Alignment of tax policy with industrial policy.
Footwear	$117 million of exports in 2015.	▪ Import duties on raw materials. ▪ Business registration and weak intellectual property protection. ▪ Limited access to credit. ▪ Labour laws and inspections. ▪ Limited access to international market information.	▪ China, Vietnam, Italy, India	▪ Clustering, including one window facilitation of Government services. ▪ Reduction of import duties on raw materials and equipment. ▪ Introduction of national standards.

Table 1.1 Summary of findings

Sector	Size of sector	Biggest Constraints	Best Practice	Recommendations
Agriculture	$650 million of horticulture exports and almost US$2 billion of rice exports in 2015.	▪ Regulatory burden, dealing with 25 different departments. ▪ Incorrecct calculations of taxes. ▪ Lack of systematic PPD.	▪ Brazil, India, Chile.	▪ Introduction of systematic PPD. ▪ Provision of market information to private sector. ▪ Review of role of Market Committees.
Livestock	11.8% to national GDP in 2015.	▪ Poorly considered import duties on inputs. ▪ Limited access to finance. ▪ Divergent national and provincial regulations.	▪ Kenya, India, Sri Lanka.	▪ Review and rationalisation of environmental and product standards. ▪ Systematic PPD mechanisms. ▪ Better enforcement mechanisms for environmental regulations. ▪ Sector specific credit schemes. ▪ Review of tax policy.

1.8 Conclusions

Businesses in Punjab face a number of challenges across all aspects of the business environment. Sectors were unanimous in identifying **tax policy** and **administration** as the biggest constraint to businesses. These constraints were cross cutting and sector specific, and have been exacerbated by the 18th Constitutional Amendment, which has resulted in duplication of taxes. Tax policy is not consistent with the economic growth ambitions set out in the Punjab Growth Strategy, and in many cases actively undermines broader objectives. Equivalent concerns apply to the Labour Department, whose mandate focuses on worker protection but at the expense of employment.

Aside from the specific recommendations, there are three more fundamental conclusions to be drawn from this research.

Government departments need better mandates which go beyond their narrow focus and reflect broader growth aspirations. These mandates need to be supported by incentive structures for employees which are carefully thought through and consider the potential unintended consequences.

Improved mandates should also support **improved coordination of policymaking** between different stakeholders. Departments need to be better at sharing information, and better coordinated during enforcement.

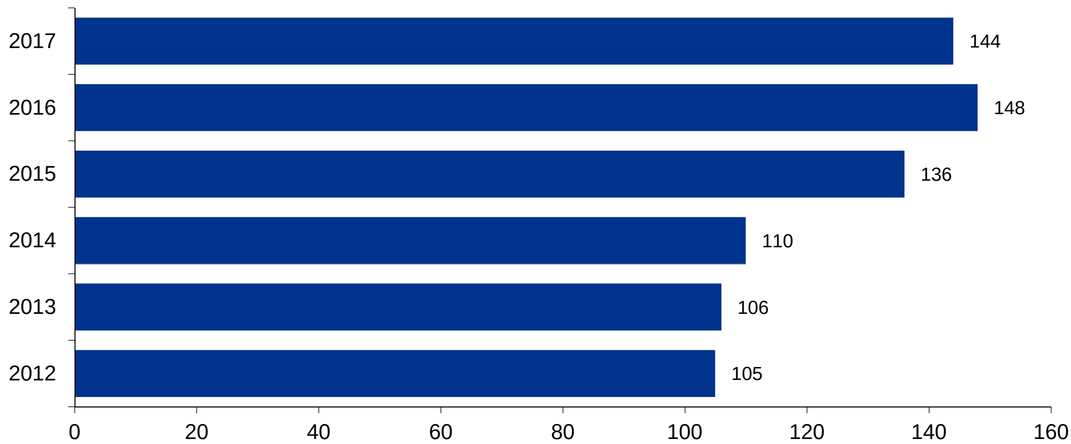
Finally, **policy needs to be based on better evidence**. A better understanding of the impact of changes to policy and regulations will only come with more proactive involvement of the private sector at earlier stages of the policymaking process. There are positive efforts being made by the GoPb in PPD, but these will only succeed if businesses believe there is a real appetite across government for positive change.

2. Introduction and Context

2.1 Background

The Punjab Government is targeting GDP growth of 8% by 2018, which will be necessary to absorb the one million people entering the workforce every year[1]. In order to achieve this, it is looking to significantly increase private sector investment and the supply of quality jobs, in particular to provide employment for its 'youth bulge'. In order to promote industrial growth the Government is seeking to emulate countries that are ranked high in the World Bank's 'Doing Business' indicators. Business in Pakistan has been constrained by weaknesses in the investment climate, in particular unreliable supplies of energy, but also macroeconomic instability, shortages of skilled labour, a lack of access to capital and international markets, weak quality assurance and standardisation, social unrest, corruption and crime. Pakistan has recently fallen in the Doing Business rankings: in 2006, it ranked 60 out of 155 countries, but had slipped to 144 out of 190 countries in the 2017 rankings.[2] The steady decline in Pakistan's ranking over the last five years is shown in Figure 2.1, below.

Figure 2.1: Doing Business: Rankings for Pakistan



Source: World Bank

[1] As indicated in the Punjab Growth Strategy 2018

[2] As of June 2016. Source: World Bank Doing Business, www.doingbusiness.org.

Although pro-growth reform actions have been initiated at the federal level, progress on BER will depend significantly on a provincial level response. Punjab accounts for more than half of Pakistan's GDP and population. The province generates 60% of national GDP and is home to more than 100 million people. The business climate and potential for economic growth in the province will therefore have a direct impact on national development. Moreover, reducing the cost of doing business has also been devolved to a considerable extent to the provinces. Four out of ten Doing Business indicators are now the purview of the provincial government. There are also a number of measures that the provincial government can undertake to improve the business environment, particularly under the newly defined roles following the 18th Constitutional Amendment. Therefore, it is timely to undertake a review to explore reforms that the provincial government can spearhead.

The Government of Pakistan is placing a greater emphasis on BER, which has led to a recent review and expansion of the IFC's program[3] to support business environment reforms and public-private dialogue in partnership with the Ministry of Finance. In Punjab, the IFC has recently established the Investment Climate Reform Unit in the Planning and Development Department which leading on reforms.

2.2 Purpose, approach and methodology

2.2.1 Purpose

The objective of this policy research was to identify the binding constraints within the business environment framework in selected priority sectors (discussed in Section 2.3). This work aims to support GoPb in achieving greater investment, employment, and women's economic empowerment, and DFID Pakistan and IFC in improving the design of their business environment reform programmes. This research should also help improve outcomes for intended beneficiaries of DFID's programmes directly (through employment opportunities for workers and wealth creation for entrepreneurs) and indirectly (through improved competitiveness and economic growth). This research is also expected to improve the quantity and quality of evidence available to other DFID central policy teams and country offices looking to support priority sectors.

[3] Under DFID's Enterprise and Asset Growth Programme, an IFC Trust Fund was established in 2014, with an investment climate component. Through this, the IFC has mapped the bottlenecks in certain key Doing Business areas and made reform recommendations, and is providing technical assistance to support these reforms. The programme includes several components, many of which involve investment climate activities, such as a virtual one-stop shop, construction permits, registering property and enforcing contracts.

It distinguishes between BER at the aggregated level and sector specific considerations.

The study objectives included the following:

- Identify the key **binding constraints** in the business environment to domestic investment and expansion in the following sectors: agriculture; livestock; manufacturing (with a focus on textiles, garments and footwear); and automotive.
- Assess the **potential** of these sectors and the implications of the identified constraints in terms of economic growth, job creation, women's economic empowerment, linkages with multinational firms and other spillovers to the local economy.
- Provide **recommendations** to the GoPb as to how these sector specific business environment constraints can be addressed, drawing on evidence on how these have been tackled elsewhere. This exercise will include an indication of the role of provincial government versus federal government in overcoming these constraints.

2.2.2 Approach

The business environment is defined by the Donor Committee on Economic Development (DCED) as a complex of policy, legal, institutional, and regulatory conditions that govern business activities.[4] It is a sub-set of the broader investment climate and includes the administration and enforcement mechanisms established to implement government policy, as well as the institutional arrangements that influence the way key actors operate (including government agencies, regulatory authorities, and business membership organisations including businesswomen associations, civil society organisations, and trade unions).

The BERF research team has employed a framework defined by DCED as shown in Figure 2.2 (below). It adopted DCED's framework as the basis for the identification and analysis of sector specific business environment reform issues in Punjab.

2.2.3 Methodology

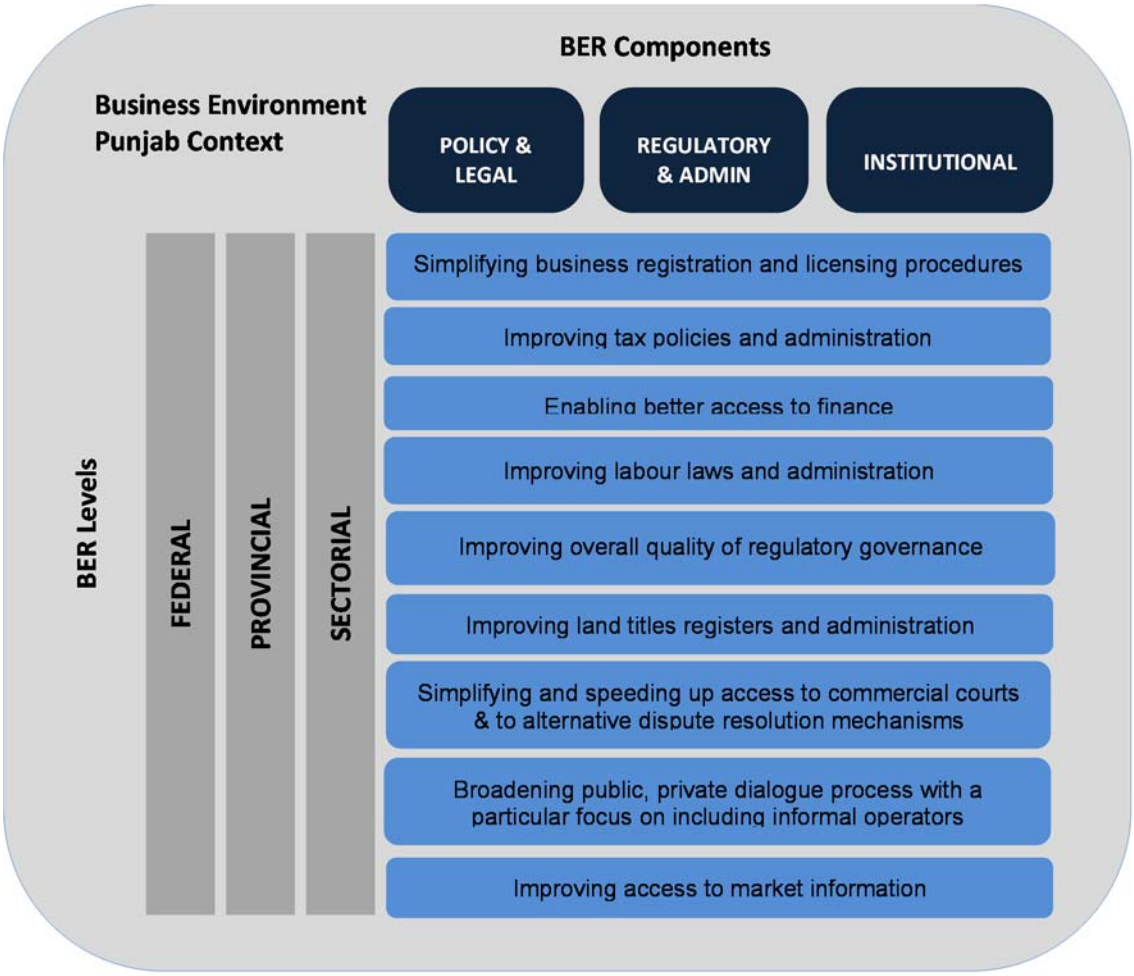
The key steps taken by the BERF team to conduct this research were:

[4] DCED, 2008.

- review existing documentation on the business environment in Pakistan and, specifically, in Punjab,
- review existing documentation on the binding constraints faced by domestic firms operating in, or contemplating entry into the agriculture; livestock; manufacturing (with a focus on textiles and garments); and automotive sectors,
- analyse existing data on the overall business environment and the constraints faced by domestic businesses in the selected sectors,
- arrange and conduct consultations with the Government of Pakistan and GoPb, domestic and international businesses (both large and SMEs) and business associations,
- assess quantitative and qualitative information which already existed and that was generated during the course of this research about the potential of these priority sectors in terms of investment, economic growth, job creation, women's economic empowerment, linkages with multinational firms and other spillovers to the local economy,
- identify relevant sector specific business environment reform policies which have been implemented in other countries or regions and assess their feasibility in Punjab,
- develop recommendations for the GoPb to address the sector specific business environment-related constraints based on the above analysis.

The BERF team coordinated closely with the existing IFC investment climate team and Punjab Investment Climate Reform Unit throughout this exercise. This involved providing regular updates to and coordinating visits and consultations with DFID Pakistan, IFC and World Bank steering committee.

Figure 2.2: Business Environment Reform Framework



Source: DCED

2.3 Sector Focus

Keeping in mind the priorities of the Punjab Government and the contribution to economic growth (measured in terms of employment and contribution to GDP and exports), this study specifically focuses on the following sectors: agriculture; livestock; manufacturing (with a focus on textiles, garments and footwear); and, automotive.

The Punjab Growth Strategy 2018 (PGS) recognises that manufacturing is an important driver of investment, employment and growth in Punjab, but has remained constrained by the poor business environment. Manufacturing's share of total investment has been steadily falling since 2000. The garments sector, in particular, is seen as having significant potential for further growth, as Pakistan is among the top five producers of cotton in the world.[5] Moreover, textile manufacturing accounts for over half of national exports and 38% of industrial employment.[6] The footwear industry in Pakistan is also the sixth largest in the world. The sector holds promise for Punjab as it accounts for almost 60% of Pakistan's 500 factories. Both the garments and footwear industries can contribute significantly to GDP growth by boosting exports and employment generation.

The PGS also identifies agriculture and livestock as key sectors for growth through improved productivity and investment promotion. Agriculture contributes significantly to the national and provincial economies, but livestock is seen as performing below potential. The Government intends to implement regulatory and institutional changes to improve the business climate in both agriculture and livestock.[7]

In addition to the sectors identified in PGS, the automotive sector is also considered here as it has significant growth potential. The Government of Pakistan approved the new 'Automobile Development Policy 2016-21' in March 2016. The policy sets an ambitious goal, given the overall economy is also expected to grow, of increasing the sector's share of a growing GDP from 2.3% to 3.8%, and increasing employment in the sector from 2.4 million to 4 million.[8]

2.4 Structure of the Report

The report opens with a discussion of findings about cross cutting BER constraints that are common to businesses operating in the priority sectors of Punjab. This is followed by sector specific chapters where each chapter contains an overview of the sector, diagnostic assessment of the sector, identification of sector specific BER issues, discussion of regional and international best practices and sector specific recommendations. Finally, the recommendations chapter provides proposed recommendations for appropriate government response and action for cross cutting

[5] Cotton Inc.

[6] Punjab Industries Sector Plan 2018: Promoting Industrial Development and Investment, January 2015, and Punjab Growth Strategy 2018: Accelerating Economic Growth and Improving Social Outcomes, March 2015.

[7] The Punjab Growth Strategy lists 12 laws and acts that will be reviewed or introduced to improve the business environment for agriculture. It also notes that outdated regulations limit the role of livestock and dairy markets, listing five laws and acts to be reviewed and that a Livestock Export Strategy will be developed.

[8] Government of Pakistan: *Automobile Development Policy 2016-21*, March 2016,

http://boi.gov.pk/userfiles1/file/AutoPolicy/AP.pdf

BER issues, along with best practice examples of how other countries have dealt with such issues.

2.5 Limitations

Provided below are some limitations faced by the research team in conducting the assignment:

- Given the overall time frame of the study agreed at the outset, the sample size was designed accordingly. Moreover, due to time constraints, the team had to restrict firm interviews with businesses based in and around Lahore. Travel to other industrial hubs of Punjab such as Multan, Faisalabad, Gujarat and Sialkot, were not feasible.
- Many of the constraints identified along the BER function were federal government issues and beyond the scope of the provincial jurisdiction. These constraints have been included in the narrative, however, the recommendations focus mainly on those areas that the provincial government can act upon.

3. Cross Cutting BER Constraints

This chapter provides an overview of the binding constraints faced by business across the sectors studied in this assignment. These have been identified following sector specific diagnostic analyses across the nine BER functional areas and are discussed below. This chapter also serves as a reference for understanding sector specific constraints that are discussed in subsequent chapters.

3.1 Business Licensing & Registrations Procedures

Several steps are required to incorporate a company in Punjab. The operating assumption during business registration is that firms applying for incorporation are already operating informally. Even though most government departments have moved to automated systems they fail to share data with each other. Consequently, an entrepreneur is obliged to resubmit similar information multiple times.

Small firms, lacking professional accountants and tax lawyers, are discouraged from registering by the sharp increase in required documentation. The burden of the tax system is discussed in Section 1.2 below.

3.1.1 Registration with SECP

A firm must first register with the Securities and Exchange Commission of Pakistan (SECP). Associations of persons may, alternatively, go through the Provincial Directorate of Industries. Businesses tend to prefer to register with SECP, as this makes it easier for them to expand their businesses and to secure international partnerships and clients.

SECP has recently adopted an online registration system which has accelerated registrations. Companies said that they still have to hire lawyers for registration purposes, who charge between PKR 10,000 and 15,000. An alternative to this is the one window facility at the Lahore Chamber of Commerce and Industries (LCCI) that is designed to assist with registrations. However, it is not clear if this facility is available to non-members.

Delays are often incurred whilst finalising company names, with some businesses reporting waits of over three months.

3.1.2 Registration with Tax Authorities

After registering with SECP, businesses need to register with various government departments for tax purposes. These include the Federal Board of Revenue (FBR) for the National Tax Number (NTN) and Sales Tax Number (STN); Excise and Taxation (E&T) Department for professional tax; Punjab Employees Social Security Institute (PESSI); Employees Old Age Benefit Institute (EOBI) and Department of Labour for social security and pension contributions; and, finally, the Punjab Revenue Authority (PRA) for sales tax on services.

Sales tax registration is complicated. The Government has to verify the company registering for sales tax is genuine. New companies seldom have the requisite information (details of suppliers and customers, bank accounts and other operational details) to validate their status, making the process complex and lengthy.

The FBR is constrained by the limited capacity of their representatives to understand new business models and respond swiftly to sales tax registration requests. Tax officers also have no incentive to facilitate businesses in their assessments and speed up tax registration, as their performance is evaluated on overall, rather than net, tax collection. Moreover, Section 176 of the Sales Tax Ordinance necessitates requisition by officials of any form of information from businesses requesting Sales Tax Registration. This is viewed by businesses as another way by which FBR delays the processing of applications.

To speed up registration, FBR has implemented Pakistan Revenue Automation Limited (PRAL), an IT based system, across its operations. For some businesses enhanced digitisation has increased their reliance on private tax lawyers to effectively utilise the online system. This also significantly escalates costs for new businesses as they can charge up to PKR 50,000.

3.1.3 Land and Building Permits and Utilities

Once the business is registered building permits and map approvals are required from Town Municipal Authority (TMA) and Lahore Development Authority (LDA). Getting LDA's approval particularly for building design takes a long time. Other registrations (such as for intellectual property rights or trademarks) may require interaction with the Intellectual Property Organisation. Dealing with all these authorities is not only time consuming, but typically requires informal payments. Firms located inside industrial estates report far greater ease in setting up than those located outside as the management of the industrial estate handles and expedites all registration processes.

3.1.4 Clearance from Environment Protection Agency

The rolling out of sector specific regulations such as the Punjab Environmental Protection (Poultry) Regulations 2013 act reflects the government's commitment to ensuring compliance to environmental laws across various sectors. However, there are clear gaps in implementation and enforcement of these regulations. As an example, the law mentioned above requires any new entrant into the poultry industry to undertake a rigorous environmental assessment prior to becoming registered. However, new entrants usually do not conduct an environmental assessment and opt to purchase a fifty-page environmental assessment document which is easily available in the market.

Key Bottlenecks: Business Licensing and Registrations Procedures
▪ SMEs face a disproportionately larger burden dealing with licensing and registration. ▪ Name selection at SECP causes delays. ▪ Sales Tax Registration is particularly cumbersome. ▪ Environmental protection laws are not effectively implemented. ▪ Acquiring building permits and map approvals from TMA and LDA is time consuming. ▪ Gaining utility connections is cumbersome especially for small firms.

3.2 Tax Policies and Administration

All key aspects of the incumbent tax system, including tax policy, tax administration and institutional capacity constrain businesses. Firms unanimously view the tax policy related to business operations as unclear, complex, and unsynchronised with the overall industrial policy objectives. Tax administration is hostile, thriving on informal payments while the institutional capacity to deal with the growing needs of the businesses remains weak.

Despite the introduction of IRIS (an online platform for e-registration for sales and income tax), the monthly and annual filing of tax returns remains more onerous, especially for SME firms as they are unable to hire tax lawyers. System slows down (possibly due to low bandwidth) and becomes exceedingly difficult to upload monthly tax returns.

Both federal and provincial tax authorities are focused on maximising tax revenue. As FBR has failed to increase its tax base through direct taxation, sales tax has become a critical source of revenue.

3.2.1 Multiple Tax Authorities leading to Over Taxation

Tax policies appear to be determined independently of industrial policy objectives, made by government departments to simply maximise tax revenue, without considering the risk of over-taxation. An emerging issue here is the duplication of value added tax, being charged by both FBR and PRA, energised over the last year or so to gain momentum in provincial revenue collection. Even though an MOU exists between the two to avoid double taxation, PRA is still perceived to be duplicating taxes. Businesses also find hiring sales and clearing agents, forwarding and clearing services, and logistics more expensive after PRA's sales tax on services. Such rising costs impact SMEs considerably as they are more reliant on sub-contracting for their orders.

This reflects a critical lack of coordination between different tax authorities, across provincial and federal jurisdiction, each chasing their own collection targets. Thus by having to deal with multiple tax authorities firms face both the risk of being overtaxed and incurring higher costs of administration. These factors can deter firms from registering altogether. Several firms engage with suppliers and customers that stay off the tax radar by making underhand payments or by simply remaining informal.

Small firms also struggle to pay the non-turnover based provincial taxes (such as property and professional taxes) applicable after the firms register without an incubation period to generate profits.

3.2.2 Ad-Hoc and frequent changes to Tax Policies

A sudden change in tax policies, often customs and regulatory duties, affects the feasibility of planned investments, especially large-scale ones yielding returns over several years.

Several firms retain tax lawyers, in addition to permanent accounts staff, to stay aware of the frequently changing and complex tax compliance requirements. Smaller firms face a proportionately higher cost in hiring specialised tax consultants. Moreover, as authorities can now challenge tax returns for up to ten years, businesses face the administrative burden of excessive record keeping. New firms and SMEs without adequate systems in place are particularly disadvantaged in this regard.

Businesses generally lack clear understanding of how property and professional taxes are determined, despite E&T department's claim to using an easily verifiable formula. Businesses say officials bringing tax invoices still have discretion over setting tax amounts which they can exercise upon receiving informal payments.

3.2.3 Claiming Tax Refunds

Large amounts of tax refund owed to businesses by the FBR is a major concern for many businesses. These claims consist of withholding taxes, mainly over-collected income tax which can be either transaction-based or in form of a customs duty, or advance income tax on last year's tax returns which in theory are refundable.

Businesses inform that in some instances informal payments of up to 25% of the amount of refunds due is demanded to release these claims. Such informal payments are viewed as a regular cost of doing business and deters some firms from claiming refunds as speed money has to be paid upfront with no guarantee that a refund will be granted.

Sales tax refund process is slow also because tax inspectors are focused more on the gross rather than net tax collection (point discussed earlier in section 1.1). Due to withholding taxes, some businesses also pay taxes for suppliers not registered to pay sales tax.

Key Bottlenecks: Tax Policies and Administration

- Non-transparent and regressive provincial taxes (more burden on newer firms).
- Filing tax returns is more onerous for small firms.
- Pending sales tax refunds tie up business capital for long periods of time.
- Over tax compliance and administration geared towards enhancing revenue through sales tax collection.
- Emerging issue of duplication of taxes by PRA and FBR.
- FBR Online Systems difficult to access and utilise.
- Ad-hoc and frequent tax changes.
- Firms have to deal with multiple tax authorities which increases the overall tax and administrative burden.

3.3 Access to Finance

3.3.1 Access to finance critical for SMEs

Most large well-established companies do not face difficulties in securing long term financing at preferential rates (e.g., KIBOR + 1 to 1.25%). SMEs struggle to obtain loans, which are mainly available for short-term working capital investments, and end up paying a much higher interest rate (in the range of KIBOR + 3 to 6%), which makes finance unaffordable to them. Thus larger and longer-term finance required by smaller or cash-strapped firms to make capital investments is not available.

There are no sector specific SME development credit products on offer by banks, or an effective State Bank Policy to ease access to finance for SMEs. Some small businesses had in the past access to loans earmarked specifically for industrial development. Currently loans are only available on commercial terms.

3.3.2 Lack of Sufficient Collateral for Small / Agri-Business

Stock of finished goods, a letter of credit for export orders, confirmed orders from suppliers and in most cases factory premises are not accepted as sufficient collateral to secure loans. Businesses end up collateralising personal property to obtain loans. Collateral offered by SMEs also undergoes a “forced evaluation” by banks, which end up under-valuing the asset, to provide a risk cover for the bank, further limiting the amount of loan that can be offered. Firms, especially new ones, often finance business expansions through unleveraged savings, substantially limiting possibilities for growth and technology acquisition.

Key Bottlenecks: Access to Finance

- A clear size bias in access to finance.
- No specific SME lending policy.
- Loans for capital investments are unavailable, particularly for small firms.
- SMEs and Agribusinesses find it harder to meet adequate collateral requirements

3.4 Labour Laws and Administration

The Labour Department has a mandate to protect workers and avoid exploitation, but is not required to promote economic growth or employment creation. Even so, it is perceived to cause harassment and intimidation rather than acting on their mandate. The Department's main objective is to ensure labour protection and welfare, but does not focus on how to make these compliances business friendly.

3.4.1 Out-dated and Vague Labour Laws

Businesses say a large number of labour compliances are out-dated. For example, there are regulations regarding bathroom fitting and fixtures made out of metal, whereas most modern plumbing is plastic based. Similarly, there are requirements for painting factory walls every six months even in factories undertaking "clean" processes, such as plastic injection moulding, where walls are clean for longer.

Businesses find that ambiguously worded regulations can lead to multiple interpretations that, depending on the understanding by labour officials, may change a firm's status from being compliant to non-compliant. This opaqueness is ripe for abuse by labour officials, who extract informal payments through threats and intimidation. Even large and influential firms report paying off labour officials, by offering speed money sometimes every month, or presenting annual cash "gifts" on occasions to keep officials at bay. Some businesses also make specific payments relating to particular aspects of the law they possibly are unable to comply with. Many businesses reported that labour officials admit that these laws are out-dated.

3.4.2 Labour Department does not Address Worker Welfare

Businesses across sectors feel that the Department fails to practically verify or ensure worker welfare. Any compliance maintained by firms is usually undertaken at the behest of their customers or industrial estate requirements, or their own consideration for their workers' welfare. The department also lacks the capacity and interest to ensure worker welfare. When labour inspectors receive informal payments, they do not even enter factory premises.

3.4.3 Firms avoid Labour Inspections

SMEs lack resources to stay informed of the voluminous and changing labour compliance requirements, and are thus unable to respond confidently to unnecessary queries and harassment, and feel threatened by labour inspections. Hence such firms prevent visits by the labour department at all costs. Most businesses claimed both Labour Department and Punjab Employees Social Security Institute inspectors make up exaggerated estimates of workers and based on their unchecked discretionary powers then negotiate commissions to settle penalty cases. Larger firms can push back unnecessary requests by hiring labour professionals and lawyers that are well informed of the law, and that handle most labour department queries, allowing the main management to concentrate on core business. Minor labour officials are also aware that better-connected and resourced firms will be able to get the labour officials removed if they experience excessive harassment.

Dealing with labour officials is also easier in industrial estates and through trade associations. In theory, department officials are not allowed to directly enter factories located inside industrial estates, but only via the industrial estate office. This extra filter ensures labour officials only communicate what is legitimate and do not threaten or intimidate firms unnecessarily.

Key Bottlenecks: Labour Laws & Administration

- Strong perception of corruption in the Labour department.
- Out-dated and vague labour laws make compliance problematic.
- Minimum wage laws impacts firms' competitiveness.
- Labour inspections primarily seen as harassment or to intimidate businesses.

3.5 Overall Quality of Regulatory Governance

The overall regulatory environment appears to be one in which firms feel threatened and intimidated, rather than supported and guided in ensuring compliance, by the government departments regardless of which one they are referred to. This reflects the single-minded objectives of the government departments to ensure compliance even if at the expense of stifling businesses.

3.5.1 Ill-Equipped Government Officials

Lack of effective governance impacts all aspects of doing business. Businesses interviewed had to deal with 18 to 26 government departments. Their usual point of contact is often a junior officer (mostly a grade 13 to 14 inspector) inducted into the system without any merit or training. Most of these appointments are either political or based on bribes by the inductee who does not have experience of dealing with businesses paying significant taxes and employing a large workforce. Businesses interviewed also felt that government inspectors have unjustifiably large discretionary powers under which they are able to arrest a CEO of a firm or shut down a factory.

3.5.2 Complex process of Compliance Certification from the Environmental Protection Department

Firms also need to obtain a No Objection Certificate for all buildings from the Environmental Protection Department (EPD). This requirement is now applicable to all buildings, even those that were constructed before this regulation became effective. Businesses felt this was unnecessary as buildings already required approvals on structural safety from other departments. According to them, this regulation was only meant to harass and elicit informal payments from firms. Some businesses confirmed taking collective action against this through the LCCI which has advised firms to report to them in case of any visits by EPD. Businesses already find it hard to comply with environmental standards due to the lack of dedicated zoning for industrial activities. Business clusters have cropped up in and around residential and commercial centres, making it difficult for firms to secure requisite compliance certification.

3.5.3 Dengue Inspections

Dengue inspection visits by government officials are meant to ensure there is no stagnant water in factory or business premises to host Dengue larvae. Some firms felt that rather than fight Dengue, the government officials seem to be fighting businesses. Officials are even allowed to register a First Information Report (FIR) against the CEO of any firm if Dengue larvae are found, and order an arrest warrant for him/her. Several firms also noted rumours of officials themselves injecting larvae into the water samples they have taken. In this context officials are easily able to extract informal payments, especially from SMEs desperate for a clearance certificate, ranging between PKR 2000 and 8000

3.5.4 Structure Stability Certificate

Following the recent series of earthquakes in Pakistan, factories are now required to obtain a building stress test / structure stability certificate. Some businesses note these certificates were only being issued by select architects, charging unreasonably high fees without necessarily inspecting the buildings.

Key Bottlenecks: Overall Quality of Regulatory Governance

- Getting certification from EPD is cumbersome.
- Dengue control teams harass firms.
- Building fitness certificates are expensive.
- Government departments are not equipped to handle businesses.

3.6 Land titles, Registration and Administration

3.6.1 Computerised Land Titles

Land titles in Punjab have now been computerised, and for simple changes in ownership, the process to transfer land is substantially quicker with reasonable costs. One business reported costs had fallen from PKR 5000 in 'speed money' to an official fee of PKR 50, and the transfer was done within half an hour as opposed to being stretched out over weeks. Land titles within industrial estates are held within the management office and transfers can be done within 24 hours.

3.6.2 Lack of coordination on Land Records

Lack of coordination between databases held by different departments makes land transfers and title changes problematic for land that is contested or requires mutation. The system has added another administrative layer to the existing process under which one has to personally visit the local courts (*katcheri*), the property registry office (*patwarkhana*), and the local tax office (*tehsildar*) to collect and physically carry forward permissions from one office to the next. There is also no common database between these offices. For example, if someone dies, the death certificate has to be presented separately at every office.

3.6.3 Inheritance laws and contested Land

This is also compounded by complicated hereditary laws making it difficult to acquire "clean" land that does not require mutation. Contested land can be challenged in court, which is a frustrating and long process, during which the land cannot be used.

3.6.4 Clearance from Punjab Environment Protection Agency

New manufacturing units need to submit an environmental plan of the chosen location to the Punjab Environment Protection Agency (EPA) for clearance before setting up any business, factory or manufacturing unit. Businesses found this challenging and said difficulties arose from the lack of proper land zoning and the unorganised growth of firms. Businesses tend to start operations from where reasonably priced land is available and there is a quick transit connection to the main road network. Subsequently business clusters began to emerge in areas that were originally earmarked for agricultural use. Firms in such areas naturally struggle more to get clearance from EPA.

Businesses also informed that they had submitted their files for EPA clearance but approval remained pending, and they risked being penalised or fined if approvals were not granted.

Key Bottlenecks: Land Titles, Registration & Administration

- Lack of coordination on Land Records.
- Inheritance Laws make it difficult to acquire some land.
- Unorganised growth of businesses makes clearance from EPA challenging.

3.7 Access to Commercial Courts and Alternative Dispute-Resolution Mechanisms

3.7.1 Ineffective Court System

There are no commercial courts in Pakistan. Business disputes are handled through judicial courts, which are often seen as ineffective, time-consuming, expensive (in terms of lawyer fees) and counter-productive. Only few firms reported taking cases to court and in doing so faced a delay of several years till a decision was given. Businesses also face inordinate delays in labour courts. Cases can take decades to be decided and in one instance the applicant had passed away before the case was concluded.

Some businesses reported accessing courts to secure stay orders against the government, allowing them to continue operating until the case is resolved, which can take many years.

3.7.2 Lack of Alternate Dispute Resolution Mechanism (ADRM)

In general, businesses don't have access to ADRM as there is no law or legal backing available to support ADRM or out of court settlements. Some minor disputes are handled by associations, however, major disputes are usually taken to court. LCCI also has a mediation centre but none of the businesses interviewed were aware of it.

3.7.3 Business avoid accessing Courts

SMEs tend to turn to courts as a last resort as they have not had positive experiences of dealing with the judiciary. Despite legal resources on their parole, larger businesses too prefer to stay away from courts and reach an out of court settlement. Firms also have to be wary of the differing interpretations amongst provincial courts, especially cases related to provincial level tax issues.

Key Bottlenecks: Access to Commercial Courts and ADRM

- Ineffective, sluggish and corrupt court system.
- No specialised business / commercial courts.
- Lack of ADRM.

3.8 Public-private Dialogue Processes

Businesses demand a public private dialogue (PPD) platform that promotes a culture of evidence based policymaking and is an effective combination of academic institutions and public and private sector stakeholders. There is no legal or formalised channel to communicate with the government on specific issues affecting priority sectors. PPD is unstructured and *ad hoc*.

Although sector associations are usually invited to main discussion forums held by the government, many of these forums are perceived as redundant and ineffective, occurring after key decisions have been made. Discussions and policy dialogues between associations or chambers and government departments are mostly issue based and reactive in nature, whereas businesses expect the dialogue to be more proactive and forward looking.

Businesses find personal relations and networks with policy makers as a useful channel to communicate. Those without personal connections have limited opportunity for accessing government departments and officers.

The non-systematic nature of PPD means it is prone to unilateral change via lobbying. This can lead to policy fluctuations as policy decisions end up being taken due to pressure rather than being evidence-based.

This necessitates a formal forum with legal backing and authority so that the views of the private sector can be brought into BER processes at an earlier stage and avoid subsequent policy reversals.

The Planning and Development Department (P&D) leads on PPD in Punjab. A PPD Council was established by the Chief Minister on 11 August 2015, headed by the Chairman of the P&D Board, although only one meeting has taken place and none of the Council members are from the private sector. A PPD Unit house in P&D will act as Secretariat.

BERF is currently working with GoPb to develop an online feedback mechanism which will enable stakeholders to provide information, opinions and recommendations to

GoPb about their priorities for reforms and the impact of policy and regulatory changes.[9]

Key Bottlenecks: Public Private Dialogue

- No formal/systematic forum for PPD.

3.9 Access to Market Information

Most firms do not consider government as a credible and reliable source for securing market information. Market information is a more pronounced issue for new entrants as no single point of information or help desk is available. It is the private sector that invests its resources to secure information about the market, what businesses to invest in and what processes to follow.

3.9.1 Role of TDAP

The Trade Development Authority of Pakistan (TDAP) uses the export development fund to offer opportunities for exhibitions and trade shows to common markets that industry players are already aware of or have access to. It does not focus on non-traditional export markets or provide support in identifying agents in targeted export countries. Businesses feel TDAP should conduct research, identify new markets and engage with the commercial attachés in countries where export opportunities for their businesses exist.

3.9.2 Lack of Able Institutions

The chambers are usually bureaucratic and only support prime members. The Small and Medium Enterprise Development Authority (SMEDA) and Punjab Small Industries Corporation (PSIC) are perceived to have become redundant over time. SMEDA had conducted some feasibility studies but these are now at least a decade old.

Key Bottlenecks: Access to Market Information

- Role of TDAP is confined and does not help businesses tap into newer markets.
- Lack of able institutions to help businesses understand the market.

[9] For further details on PPD structures in Punjab and the proposed online feedback mechanism, see *Scoping Visit for an Online Feedback Mechanism, Punjab, Pakistan*, BERF, August 2016.

4. Cross Cutting Recommendations

This chapter consolidates findings for cross cutting BER constraints and presents recommendations for these in light of best practices observed in other countries. It is important to note here that some constraints are more binding than others and therefore have a greater impact on the cost of doing business. The government's reform agenda should ideally focus on addressing these binding constraints. The BER functions are discussed in the same order as in Chapter 2.

4.1 Business Registration and Licensing Procedures

4.1.1 Issue

Setting up a new business is cumbersome, involves several procedures and dealing with a number of government agencies. The process can be completed online now and there are professionals that can be hired to facilitate this process. Therefore, delays encountered and paperwork required to register a business is more an irritant than a major impediment.

4.1.2 Best Practices

New Zealand registers new firms in half a day and they only have to deal with one entity, the Companies Office, for online registration.

Thailand provides a single point service center to process applications previously handled by three different government agencies.

Macedonia offers e-registration via a certified government agent that prepares an application, drafts and reviews company deeds, and converts paper documents into a digital format. The agent digitally signs the forms and submits registration packets to a Central Register on behalf of the company.

India has amended the Companies Act in 2015 to eliminate minimum capital requirement and ended the requirement to obtain a certificate to commence business operations to support SMEs.

4.1.3 Recommendations

Quick Wins

1. PBIT to advocate SECP to **link the company name database with the online application** so the proposer immediately knows what which options are available.
2. PBIT to advocate the Intellectual Property Organisation (IPO) to **link the company name database with the online application** so that the proposer already knows that what they are registering as a patent and name of logo is unique.

3. PBIT to, with the help of PITB, establish a **centralised helpline** to facilitate queries regarding the application and approval process for businesses in Punjab. The helpline must have clearly defined working hours and the helpline operators would need to be trained to answer business related queries.

Medium to Long Term – Provincial Government interventions

4. GoPb to provide a **one-window operation for all provincial government registrations, taxation, monitoring and compliance**. One way could be to establish more industrial parks (see box below).

Box: Industrial parks - A Cross-Cutting Recommendation

Industrial parks offer a substantial advantage by easing the binding business environment constraints. Industrial parks are within the remit of provincial government, and the current model of developing and managing industrial parks has worked well for Punjab. Expansion and further development of industrial parks would be a useful way to support existing firms and provide an environment to incubate new firms.

There are several binding constraints that industrial parks can facilitate which fall within the BER functional areas (business registrations under one-window facilitation, interaction with labour and other departments and land titles). Industrial parks also provide infrastructure, which is an important part of the investment climate, even if it is not a BER functional area.

The workforce for each unit inside the parks can be registered with the park authority responsible for managing EOBI, social security and other worker benefits. Environmental compliance can be filed with the park authority that will deal with EPA. Development of parks can be such that the environmental and building safety issues are already addressed.

Land in industrial parks has now become very expensive, so this expansion in supply and possible subsidies would help make land and the facilities within it accessible and affordable.

Industrial parks can also facilitate clustering, which has been shown to be effective in promoting some of the priority sectors in other countries.

Provincial Government to Advocate with Federal Government

GoPb via the P&D department can lobby the federal government (mainly SECP and FBR) to simplify registration processes by reducing the number of intermediary steps and organisations involved. A single portal registration must have a shared database between FBR, Labour Department, and provincial tax authorities. National Database and Registration Authority (NADRA) can facilitate automatic registration with all the concerned departments and ensure real time updates of data across all databases.

4.2 Tax Policies & Administration

4.2.1 Issue

Taxes are frequently changing, complex and unsynchronised with industrial policy objectives. Firms end up incurring heavy costs in fulfilling requirements of the provincial and federal tax authorities. This is a serious obstacle to investment and growth.

4.2.2 Best Practices

Moldova has developed a single, coherent, and comprehensive tax code which is well written and easily accessible through the website of the State Fiscal Service.

Jordan has developed a similar comprehensive tax code, recently placed before its economic cabinet for consideration.

Indian parliament passed an amendment in 2016 to simplify the sales tax system on the principle of 'one nation one tax'. Sales tax on goods and services including various other indirect taxes paid at the federal and state level are to be replaced with a single goods and services tax.

Bosnia and Herzegovina replaced 70 different regional taxes with one tax. The revenue is shared with *cantons* (sub-national regions). For example 5 different taxes on real property use are replaced by a single, comprehensive tax on real estate.

Bangladesh provides manufactured goods exporters refunds on customs duties and sales taxes paid on importing raw materials used to produce goods. Exporters can also obtain drawbacks on VAT on local inputs used in production. Import tariffs on exported goods are eliminated in these special customs areas.

Vietnam: Sales taxes on inputs are zero-rated and refunds are made within ten days.

4.2.3 Recommendations

Quick Wins

5. Provincial tax collection authorities like PRA and E&T to clearly indicate on their invoices the **basis for calculation of provincial taxes**. For example, E&T department uses a set formula to calculate professional and property taxes which most firms are unaware of.
6. The Finance Department to work with the Industries Department to introduce an **incubation period (**of two to five years) for new firms in which they are not required to pay the non-revenue based provincial taxes until they are financially viable.

Medium to Long Term – Provincial Government interventions

7. Provincial tax authorities PRA and E&T to introduce a **single agency to collect provincial taxes** with real time data sharing so as to avoid duplication and over-taxation. GoPb can issue a single ID for all provincial taxes. Finance Department along with the Board of Revenue can take the lead on this.

8. The Industries Department, as part of its upcoming industrial strategy, to provide clear **guidelines on all provincial tax policies** affecting businesses (especially for priority sectors).
9. GoPb to make **PRA more transparent** and business friendly. The list of services to be taxed by PRA can be displayed on their website to help reduce the perception of discretion.

Provincial Government to Advocate with Federal Government

10. GoPb to lobby with FBR, through Finance and P&D Departments, to change and improve **provincial-federal coordination** in order to minimise over-taxation and to help synchronise federal tax policies with provincial industrial policy objectives.
11. GoPb to lobby via Finance Department to facilitate the processing of **sales tax refunds** pending due to PRA-FBR coordination issues.
12. GoPb to advocate with FBR to develop and run **training programs for provincial tax officers** dealing with industry on new business models and applications.
13. GoPb, in coordination with Finance Department to direct the FBR to base **performance evaluation of tax inspectors** on gross rather than net tax collection.

4.3 Labour Laws and Administration

4.3.1 Issue

Compliance with numerous labour laws is challenging and dealing with the Labour Department is cumbersome and costly, particularly because of informal payments. The need to reduce direct interaction between business and labour inspection teams is becoming critical. This came out as one of the key bottlenecks faced by businesses across all sectors. Constraints under this BER function fall within the purview of GoPb.

4.3.2 Best Practices

The **Indian** state of Maharashtra launched a Labour Management Solution (LMS), an online-interface for businesses to interact with the Labour department. Firms submit online license and renewal applications. E-interface has also drastically reduced the need for physical inspection of premises for compliant businesses, sped up process of approvals and enhanced industrial safety and inspection due to readily available online checklists for both Labour department staff and businesses.

Sri Lanka's Ministry of Labour introduced an integrated inspection system with the assistance of the ILO, where a multidisciplinary team of inspectors visit a factory to carry out an overall evaluation of all aspects of compliance.

4.3.3 Recommendations

Quick Wins

14. PBIT to work with the Labour Department to develop a short **labour code compliance booklet** that contains information on all applicable laws that businesses must comply with. The Industries Department can help develop a simple template where the businesses can tick off all the requirements. This compliance booklet can also be used as a basis for when Labour Department conducts business audits.
15. The Labour and Law departments to commission a **comprehensive review of labour regulations and laws** to help develop a new business friendly labour code. The large number of labour laws would be reviewed, prioritised and streamlined into a smaller number of directives which the Labour Department has the capacity to properly implement.
16. The Labour Department to incorporate a **business friendly compliance regime** to support the objectives of the Industries Department while designing policies and administration procedures. Both departments can publish a well-defined inspection procedure and checklist on their website.

Medium to Long Term – Provincial Government interventions

17. The Labour Department to enforce a rule by which **labour officials can only approach firms indirectly** through associations or Industrial estates or other intermediaries rather than directly.
18. Labour and Industries department to launch a computerised **risk assessment system for identifying establishments to be inspected**. Inspection requirements, under various labour laws, can be differentiated based on the risk profile (such as high, low, medium) of different industries. Low risk industries with a history of satisfactory compliance can either be exempted from inspection or provided the option of self-certification. Third party certifications, instead of departmental inspections, can be allowed for medium risk industries.
19. GoPb to launch an **integrated labour inspection system**. The system should mandate online submission of inspection report within 48 hours to the Labour Department, and allow users (businesses) to login to the portal to view and download submitted inspection reports. The department could introduce computerised allocation of inspectors. This effort could be led by the Labour Department with help from the Punjab Industrial Estates.

4.4 Access to Finance

4.4.1 Issue

There is limited formal access to credit for businesses that require long-term working capital. SMEs, generally, are unable to obtain loans from banks due to inadequate collateral and thus have to rely on personal savings. This is not a major binding constraint but is a common bottleneck experienced by businesses across sectors.

4.4.2 Best practice

Mexico's state-owned nation-wide development bank Nacional Financiera (NAFIN) developed a productive chains program to link large, creditworthy buyer firms with small, risky firms unable to access formal finance.

Romania introduced a law governing secured transactions and established electronic registry for collateral to include all registered security interests.

Solomon Islands simplified all aspects of lending through the Secured Transactions Act passed in 2008, which made it easier and quicker for individuals to obtain business loans using movable assets such as boats, cars, or farm equipment as collateral.

In the **USA**, a uniform public collateral registry is in place for both the moveable and immoveable properties on a state level and the secured parties include any type of creditor who provides value to the borrower.

In **Italy**, the SME financing law resulted in outflows of US$ 23 billion on terms that are suited to needs of SME.

4.4.3 Recommendations

Quick Wins

20. Bank of Punjab (BOP) to facilitate **alternatives to collateral**, such as investment specific loans to SMEs on the basis of confirmed orders from large clients, to facilitate investments in capital and technology.
21. SBP can work with commercial banks such as BOP to **earmark loans at preferential rates** for industrial investments, especially for SMEs. It can develop specific credit schemes to suit the needs of SMEs, such as credit based on back-to-back LC for export.

Medium to Long Term – Provincial Government interventions

22. SBP working with the BOP, to pilot **credit schemes for SME exports** with special rates that can be linked to export performance. The banks could charge a penalty where businesses fail to meet the export target.

23. BOP to launch a **Public Credit Guarantee Schemes** (CGSs), already used by more than half the countries of the world, which would allow banks to mitigate the risks of lending to SMEs. Here, the SMEs absorb a portion of the lender's losses in case of default, typically in return for a fee. SBP has already launched one such scheme limited to small farmers.

Provincial Government to Advocate with Federal Government

24. GoPb to work with SBP to implement strong policy guidelines and a supportive regulatory environment to offer **financial products that support SME development** in the long run.
25. GoPb to create a **uniform collateral registry** for all types of lenders by either delegating provincial and federal functions to one body or leaving the subject to be dealt with by the provinces. The legal frameworks for secured transactions needs to be developed, along with an electronic movable collateral registry. The Financial Institutions (Secured Transactions) Act, 2016 was passed by the senate in mid-2016. Strengthening credit bureaus can reduce lending risk.
26. GoPb to encourage Banks to use **a credit reference bureau** to provide information on a client's borrowing history for the past five years, enacted through a law. The SBP's subsidiary, National Institute of Banking And Finance (NIBAF), could take the lead on strengthening credit bureaus.

4.5 Overall Quality and Governance

4.5.1 Issue

Lack of efficient and effective governance affects all businesses as it significantly increases compliance costs. This was one of the most critical binding constraints identified by businesses interviewed.

4.5.2 Best practices

In **Bangladesh**, brands established the Accord (mostly European brands) and the Alliance (mostly US brands) to conduct structural and fire-safety audits in factories and recommend specific improvements. ILO has built capacity of public inspectors and related government agencies and coordinates the efforts to develop a common standard for building and fire safety inspections.

By 2008 **Croatia** consolidated most inspection processes into a single autonomous agency, the State Inspectorate. The number of units that conduct inspections has been reduced from 110 to 49, and the number of county offices cut from 22 to 5.

The **UK** introduced the Primary Authority concept whereby a business enters into a partnership with one enforcement body, which then becomes its primary contact for advice, planning and help with trading law across the UK. Local authorities first contact the Primary Authority, rather than the business itself regarding evidence of that business's compliance with legislation, even if the business has offices in different regions of the country.

Denmark: The Working Environment Authority published risk assessment checklists, for 60 different sectors, designed to help SMEs carry out the mandatory risk assessment themselves. The checklists contain a series of questions which businesses need to answer through a simple yes or no. All newly recruited inspectors are allocated a mentor (experienced inspector) throughout the first year of service.

4.5.3 Recommendations

Quick Wins

27. Health Department to set up a group of **pre-qualified Dengue spray companies** which businesses can then use. The approved companies can issue Dengue compliance certificates to businesses. The Government can then focus on only monitoring the working of the dengue spray companies and not have government representatives enter business premises.
28. LDA, in collaboration with PBIT, to mandate use of software (such as AutoCAD) for **online verification of building plans**. These softwares have the capability to automatically scan building plans and monitor compliance with building byelaws and building codes.
29. PBIT to establish an **Investor Facilitation Cell** to guide and assist investors. This facility can also be used by companies outside of Pakistan that are looking to invest in Punjab.

Medium to Long Term – Provincial Government interventions

30. Industries Department to take the lead and work with other provincial departments to **remove non-essential provincial regulation** and avoid duplication, such as in the case of building compliances and environmental compliances. For large buildings, inspections by various government agencies can be integrated into a single or joint inspection.
31. Industries Department to **incorporate compliance incentives** for businesses as part of a larger package of industrial development. This would ensure that firms are not stifled with excessive compliances, but the compliances are counter balanced with positive incentives to encourage and support firms. For example, in several countries the requirement for producing environmentally friendly vehicles is encouraged through a set of investment incentives such as tax breaks to support the technology acquisition required by the auto sector. The same could be replicated in Punjab and across priority sectors.

32. GoPb to enact legislation (e.g. Right to Services Act) to mandate **time-bound delivery of services to businesses**. The legislation can lay out punitive measures against officials who do not abide with these timelines. Legislation can initially cover time-bound service delivery for any four of the following registration or licensing processes: labour, environment, land, construction permits, power/electricity connections and provincial taxes.

4.6 Land titles, Registration and Administration

4.6.1 Issue

Delays in land transfers and inefficient titling makes land registration a challenge. With renewed focus on industrial parks and digitisation of land records this is not a major constraint for businesses.

4.6.2 Best Practices

Bhutan has launched an online land transaction system, E-Saktor, to connect the databases of the Thimphu Municipality and the National Land Commission, and allow users to check information on property boundaries and ownership, and to submit land transactions electronically.

India's Madhya Pradesh and Gujarat have both published details on the available land banks in their states. Gujarat has also implemented a robust GIS system to provide details of land earmarked for industrial use.

Hungary has a very wide selection of industrial parks investors can choose from – there are over 160 operating industrial parks in the country that cater to different businesses.

Morocco's EI (Pacte National pour L'Emergence Industrielle) introduced an Integrated industrial Platforms (P2i) program to assist in developing a diversified supply of land for industrial use, adjusting to the needs of firms working in priority industries and creating new areas of economic activity, accompanied by the rehabilitation of several industrial zones.

4.6.3 Recommendations

Quick Wins

33. GoPb to ensure **access to information on the availability of land** for business. The Land Record and Management Information System (LRMIS) is being developed to record this information and this data should be made public.
34. GoPb to launch a framework to **earmark land parcels** with the kind of industry that can be established on such land. Punjab could clearly define the criteria used in

land allocation via a notification or legislation and make this information available online.

35. GoPb to make available a format of **model sale deed for property registration** on the website of the LRMIS and enable use of e-stamps. The pilot that has been launched by Board of Revenue with help from PITB is currently facing problems that need to be resolved. Moreover, users should be able to collect e-stamps at the time of property registration at the registrar's office which will remove the need for them to go to the bank to collect the challan or e-stamp.

Medium to Long Term – Provincial Government interventions

36. GoPb to establish a **dedicated conflict resolution mechanism** for disputes relating to land allotment and construction permits. Independent professional appeal mechanisms can be developed that bypass the formal judicial system with assistance from the provincial Law Department. These mechanisms would reduce burden on courts and help address disputes between building professionals and permit granting authorities on the interpretation of the building code or compliance.
37. GoPb to design and implement a system for **online payment, registration and downloadable and verifiable certification** to improve property registration. Seamless tracking of applications regarding property registration should also be introduced.
38. GoBP to **develop pre-cleared land banks** within the LRMIS for industrial use and investors can apply for them through an online website. To ensure more effective and targeted enquiry, investors should be able to filter the data on land banks according to the type of industry permitted to be established on the land.
39. GoBP to work with LDA to **make LRMIS GIS information available**. GoPb also has a GIS system which can be applied for land use and cover mapping to earmark land for industrial use, and provide information on road and water pipelines. Technical support can be sought from the Urban Unit on this matter.

4.7 Access to Commercial Courts and to ADRM

4.7.1 Issue

Firms generally avoid litigation and opt for out of court settlements as business funds end up being blocked by legal disputes that last for a very long time. Though access to justice is a crucial service delivery concern for Pakistan, its impact on businesses is limited and may not be a priority in the larger scheme of BER constraints.

4.7.2 Best practice

India's High Court in Maharashtra constituted and prescribed seven commercial benches exclusively for the purpose of resolving commercial disputes and equipped District Courts with the provision for making online payments to save time and cost.

In Balkans, the IFC launched several alternative dispute resolution pilot projects to support relevant legal frameworks, create pools of expert mediators, establish networks of sustainable mediation centres and educate the broader public to the benefits of mediation.

In Korea the electronic case filing system allows for electronic filing of civil, commercial, administrative and family-affairs cases and will soon integrate insolvency cases.

4.7.3 Recommendations

Quick Wins

40. For Industrial Estates, GoPb to develop an **ADRM policy** to provide some legal cover and give the mandate to the Industrial Estate and sector association's administration to resolve disputes.

Medium to Long Term – Provincial Government interventions

41. GoPb to establish a **specialised division/bench under the High Court to hear commercial cases** and establish specialised courts at the district court level to resolve commercial disputes.
42. The Law Department to develop a **provincial policy to provide legal cover** to out of court mediation and advocate for it to become national law.
43. GoPb to design and implement a system to allow **e-filing, e-summons and e-payment of court and process fees** in cases of commercial disputes at the high court and district court level. This system can also allow digitally signed court orders to be issued online.

4.8 Public-private Dialogue

4.8.1 Issue

Non-systematic PPD results in bad policymaking that does not reflect the needs or realities of businesses. Consequently, the chances of implementing policies that hamper the business environment is greater.

The GoPb is already making efforts to formalise PPD structures through the creation of a PPD Council, headed by the Chairman of the P&D Board, and the development of a PPD Unit. The Industries Department is also developing an advisory panel with representatives from the private sector. These are welcome developments.

BERF is working with GoPb to develop an online feedback mechanism. In a separate report which focuses on PPD, it was recommended that this was housed within the Investment Climate Reform Unit (ICRU). ICRU was selected over PBIT because PBIT lacked the decision-making authority and did not represent SMEs.

4.8.2 Best practices

Indonesia's Regional Agribusiness Competitive Alliances (RACAs), established at the district, provincial and federal level, seeks to ensure a balanced representation of all stakeholders.

Liberia established the Liberia Better Business Forum (LBBF) as a new mechanism to facilitate dialogue on investment climate issues. Public and private representatives serve on the governing board and on targeted working groups to tackle corruption, and improve tax and customs procedures, and access to finance and electricity.

Nigeria encouraged public private dialogue around business environment issues and strengthened the role of the media as a driver of reform and to inform dialogue.

4.8.3 Recommendations

44. GoPB to **develop a sector specific focus in the online feedback mechanism,** and any future PPD efforts before being more generally rolled out. This should bring together the relevant business member organisations identified in this report, with the government departments and agencies which set the rules and regulations affecting businesses in those sectors. P&D and the ICRU will need to play a central role in bringing stakeholders together. Such efforts will only ultimately succeed if the different public sector stakeholders' mandates and incentives are aligned with supporting growth in the sector.

4.9 Access to Market Information

4.9.1 Issue

Businesses find it difficult to access accurate and timely data and information. The availability of market data is weak across sectors and businesses struggle to get access to the data that is already available with various government agencies, such as prices and quantities of imported products.

4.9.2 Best practices

Vietnam introduced legislation that increased transparency by requiring publication of all national-level legislative documents for 15 days in the Official Gazette before they came into effect. This was done to improve transparency as well as participation from businesses and citizens. Recommendations

Quick Wins

45. GoPb in collaboration with PBIT to **facilitate access to non-confidential data** already collected by various government agencies. Information gathering and dissemination on trade, agri-business and potential markets should be strengthened.
46. PBIT to **commission sector and market studies for priority sectors** that aim to identify entry points and requirements in non-traditional markets. The studies should also focus on trade policies in these countries so that the industry is better able to meet those requirements.
47. PBIT to also collaborate with universities and institutions to offer **short courses for business executives** on topics like business processes, national laws, trade laws and international requirements. This flow of information will enable businesses to better deal with domestic and international regulatory requirements.

Medium to Long Term – Provincial Government interventions

48. As part of a one window facilitation services, PIBT to develop and publish online a comprehensive **checklist of all requirements to establish a business** (such as No Objection Certificates, licenses, registrations and other mandatory provincial and federal approvals). This could help business make informed decisions about investment.

Provincial Government to Advocate with Federal Government

49. TDAP to conduct research, **identify new markets and engage** with the commercial attachés in countries with the relevant business sectors.

The recommendations are summarised in the table overleaf.

Lead	With	Rec. Num.	Area	Quick Win?	Summary
GoBP	FD	4	4.1		Provide one window operation for registration
GoBP	PRA	9	4.2		Make working of PRA more transparent
GoBP	FBR	10	4.2		Improve provincial federal coordination
GoBP	FD	11	4.2		Facilitate processing of sales tax refunds
GoBP	FD, FBR	12	4.2		Training programmes for principal tax officers
GoBP	FD	13	4.2		Performance of tax collectors on gross tax
GoBP		19	4.3		Launch integrated inspection system
GoBP	SBP	24	4.4		Offer financial products for SME development.
GoBP		25	4.4		Create uniform collateral registry
GoBP		26	4.4		Encourage banks to use credit reference bureau
GoPB		32	4.5		Legislation to mandate time-bound services
GoPB		33	4.5	Yes	Assure access to information on land availability
GoPB		34	4.5	Yes	Launch framework to earmark land parcels
GoBP		35	4.5	Yes	Provide format for model sale deed for property
GoPB		36	4.6		Dedicated conflict resolution mechanism
GoBP		37	4.6		Online payment, registration and certification
GoBP		38	4.6		Pre-cleared land banks
GoBP		39	4.6		GIS information available in LRMIS
GoBP		40	4.7	Yes	Develop ADRM policy for industrial estates
GoBP		41	4.7		Specialised division/bench for commercial cases
GoBP		43	4.7		E-filing, E-summons and E-payment for courts
GoBP		44	4.8		Sector focus in Online Feedback Mechanism
GoBP	PBIT	45	4.9	Yes	Access to non-confidential information
PBIT	SECP	1	4.1	Yes	Link company database with online application
PBIT	IPO	2	4.1	Yes	Link company database with online application
PBIT	PITB	3	4.1	Yes	Centralised helpline for application and approval
PBIT	Labour	14	4.3	Yes	Labour code compliance booklet
PBIT		29	4.5	Yes	Establish Investor Facility Cell
PBIT		46	4.9	Yes	Sector and market studies for priority sectors
PBIT	University	47	4.9	Yes	Short courses for business executives
PBIT		48	4.9		Checklist of requirements for establishment
PRA	E&T	5	4.2	Yes	Indicate basis for tax calculation on invoices
PRA	E&T	7	4.2		Single agency to collect taxes
Fin.	Indust.	6	4.2	Yes	Incubation period (tax holiday)
Indust.		8	4.2		Guidelines on tax policies
Indust.		30	4.5		Remove non-essential regulation
Indust.		31	4.5		Incorporate compliance incentives
Labour	Law	15	4.3	Yes	Review of labour regulations and laws
Labour		16	4.3	Yes	Incorporate business friendly compliance
Labour		17	4.3		Only approach firms indirectly

Lead	With	Rec. Num.	Area	Quick Win?	Summary
Labour	Ind.	18.	4.3		Computerised risk assessment inspection
Law		42	4.7		Provincial policy for legal cover
BOP		20	4.4	Yes	Facilitate alternatives to collateral
BOP		23	4.4		Launch Public Credit Guarantee Schemes
SBP	BOP	21	4.4	Yes	Preferential loans for Industries / SMEs
SBP	BOP	22	4.4		Pilot credit schemes for SME exports
Health		27	4.5	Yes	Group of pre-qualified Dengue spray companies
LDA	PBIT	28	4.5	Yes	Online verification of building plans
TDAP		49	4.9		Research new export markets

5. Garments Overview

Textiles are a critical component of Pakistan's manufacturing sector, with one of the most established production chains that encompasses: cotton growing; ginning; spinning; fabric production; dyeing and finishing; and, made-ups and garment manufacturing.

Pakistan is among the top five producers of cotton in the world, accounting for 9% of total world output of cotton.[10] The textile industry accounts for 8.5% of Pakistan's GDP; nearly 25% of industrial value-addition; 40% of industrial employment; and consumes about 40% banking credit.[11] Barring seasonal and cyclical fluctuations, textiles products make up US$13 billion, or around 60% of national exports in 2015.[12]

The readymade-garment sub-sector has emerged as one of the important SME industries in Pakistan and accounted for US$4.5 billion, or 20% of national exports in 2015.[13] There are large domestic and global markets, and firms are internationally price competitive. Pakistan specialises in basic cotton, woven, denim and chino trousers, low-priced knitwear (such as, polo shirts and t-shirts) and fleece sweatshirts.[14] However, the sector continues to suffer from political instability and the worsening energy crisis.

Amongst the top products exported by Pakistan were cotton and other woven trousers (including denim), which accounted for US$1.5 billion of exports,[15] knitted trousers (over US$ 200 million),[16] t-shirts (almost $300 million),[17] shirts ($520 million),[18] jackets,

[10] Cotton Inc.

[11] Economic Survey 2014-15

[12] Source: UN Comtrade

[13] Source: UN Comtrade.

[14] Lopez-Acevedo, Gladys, and Raymond Robertson, eds. 2016. Stitches to Riches? *Apparel Employment, Trade, and Economic Development in South Asia. Directions in Development*. Washington, DC: World Bank. doi:10.1596/978-1-4648-0813-5. License: Creative Commons Attribution CC BY 3.0 IGO

[15] Source UN Comtrade. HS codes 620342, 620349, 620462, 620463, 620469

[16] UN Comtrade HS Codes 610349 and 610342.

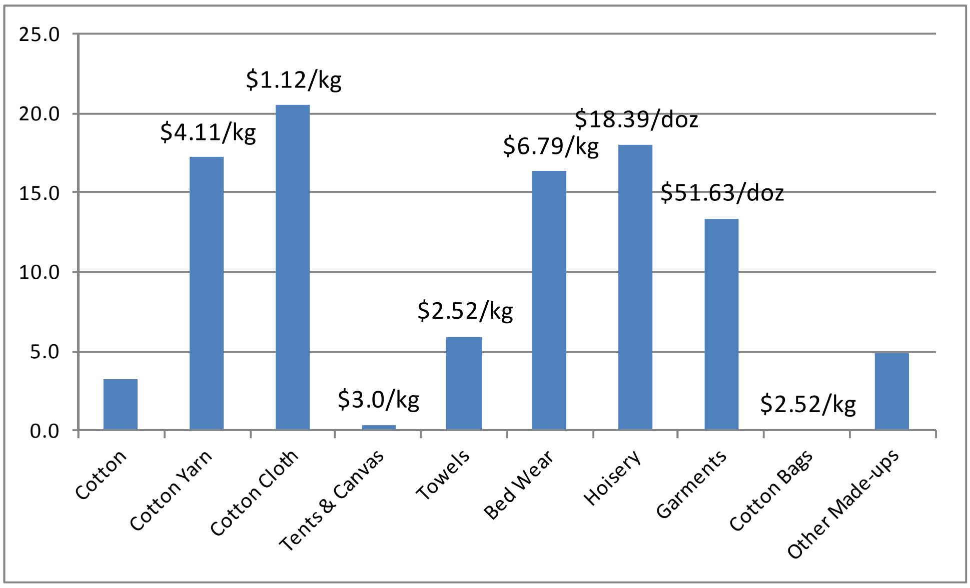
[17] UN Comtrade HS Codes 6109.

[18] UN Comtrade HS 6105.

blazers and woven 'ensembles' (US$260 million),[19] and socks and tights (US$330 million).[20]

Even though there is a large domestic and global market for garments and Pakistani firms are price competitive, these firms add little value as they are supplying products that have limited growth potential (see Figure 5.2 below). The price competitiveness historically was driven by the 6% Research and Development Grant and now is mostly due to local raw material (such as denim) and low labour costs.

Figure 5.1: Percentage Composition of Pakistan's Textile Exports along with Average $ Price (2011)



Source: Data taken from www.aptma.org.pk seen on 06 March 2013.

The garments industry is particularly important to the economy of Pakistan and Punjab for a number of reasons. It is the most labour intensive and least capital intensive segment of the textile industry, and has great potential for employment generation. For instance, 50,000 kg of cotton fibre created 400 jobs in spinning, weaving and finishing stages and almost 1,600 jobs in garments manufacturing.[21] The industry comprises of firm of varying sizes, however, the firms are all locally owned.

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[19] UN Comtrade HS Codes 620322, 610339 and 610332.

[20] UN Comtrade HS Code 6115.

[21] Discussion with Industry

Table 5.1 Textile Sector Overview

Sector	Number of units	Production	Exports (US$ billion)
Ginning	1260	20 million bales	0.36
Spinning	442	2.9 billion Kg yarn	2.23
Weaving	124 large 425 small	1 billion sq meters cloth	
Finishing	10 large 625 small	4.8 billion sq meters cloth	2.64
Garments – woven	50 large 2500 small	670 million pieces	1.77
Garments – Knitwear	2500	350 million pieces	2.31
Towels	400	53 million kgs	0.76
Synthetic Fabric		148 million sq meters	0.67

Source: PRGMEA

Garments add the most value in production compared to other textile sub-sectors. US$1 million invested in spinning and weaving will on average produce only US$0.27 million worth of exports annually, compared to around US$3.2 million exports from an equivalent investment in garment production. These exports improve Pakistan's balance of trade.

The Punjab Government has identified the garments sector as central to the industrial sector in the Punjab Growth Strategy (PGS). Despite this, there has been limited focus on business environment reform within the sector. The PGS work plan emphasises the need for customs facilitation to speed up exports; the development of economic zones to address issues of suitable land availability, environmental compliance, business registration and permits facilitation; and promulgation of special incentives such as tax holidays within the zones.

5.1.1 Export Potential

Pakistan currently enjoys 2% of the total share in global textile trade, with US$12.9 billion of exports in 2015.[22] However, it still needs to catch up in garments exports with its key competitors and has been hurt by the appreciating Pakistani Rupee.

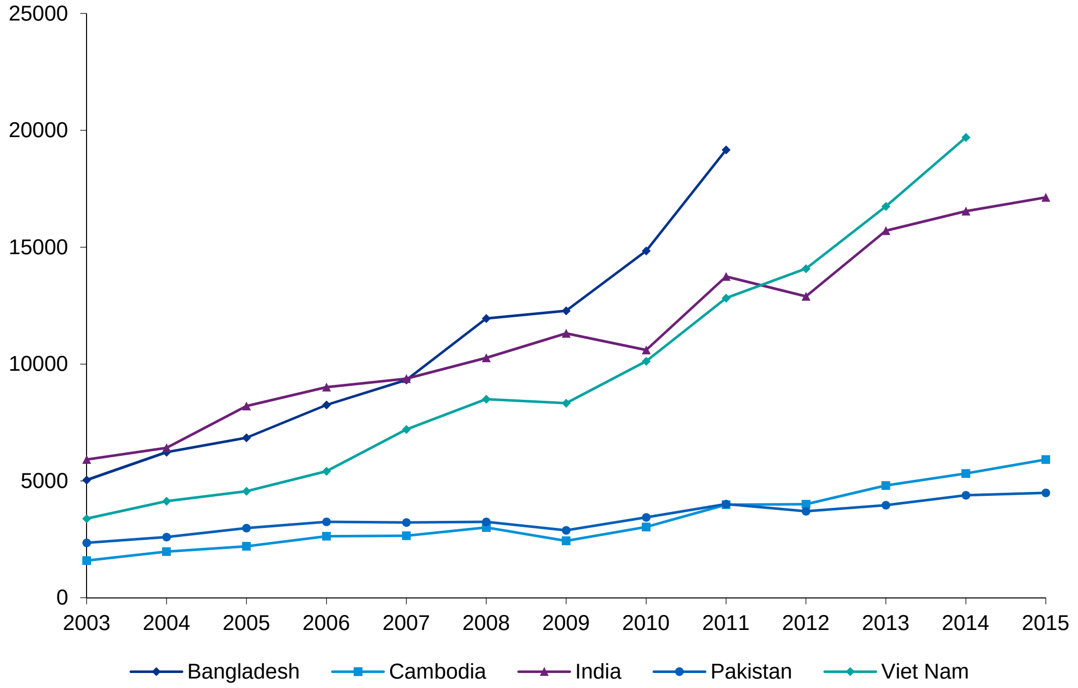
[22] Source: UN Comtrade.

Exports of ready-made garments were $4.5 billion in 2015; around 1.2% of global trade, similar to that of Sri Lanka. China (including Hong Kong) dominates world exports of garments, with over 40% of the market. Behind China, the largest shares of exports in the region are held by Bangladesh (US$24.6 billion in 2014),[23], Vietnam (US$20 billion in 2014) followed by India (US$17.1 billion in 2015), Cambodia (US$5.9 billion in 2015) and Sri Lanka (US$4.5 billion in 2014).[24] When compared to exports of competing countries in the region, the growth in Pakistan's exports appears modest (see Figure 5.3). This is mainly due to the sector's persistent involvement with low value goods and not moving into Original Design Manufacturing in the global value chain. Other factors hampering growth of this sector include cost and availability of electricity, skills, technology, credit and inconsistent and frequent policy shifts.

[23] World Trade Organisation 2015

[24] Source: UN Comtrade, apart from Bangladesh.

Figure 5.2: Exports of Garments by selected countries, 2003 - 2015, US$ million.



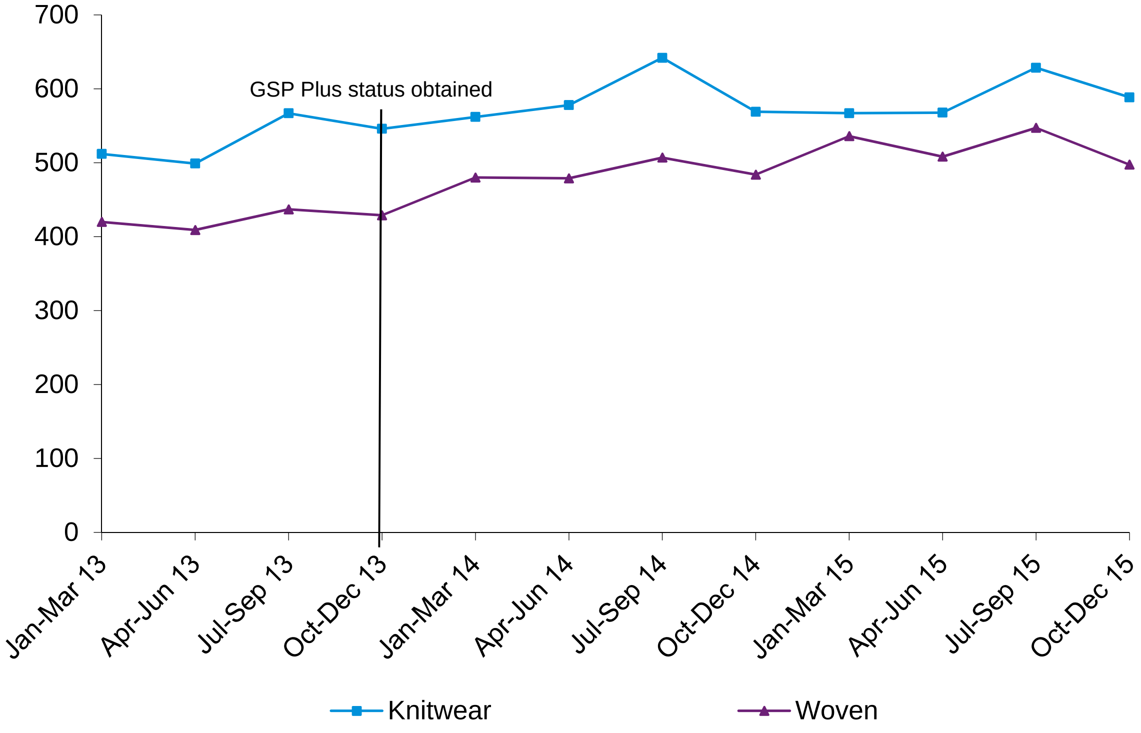
Source: UN Comtrade.

5.1.2 The impact of GSP plus

Pakistan was granted the GSP plus status[25] which became effective on 1 January 2014. This status provides Pakistan duty-free access to the EU market for export of garments. However, its positive impact on exports has been limited due to lack of awareness, depreciation of the euro and issues of compliances. Woven goods have seen higher growth than knitted ones (Figure 5.4). The woven sector, which is mostly cotton-based, has taken advantage of the recent fall in cotton prices which has led to a reduction in costs. This change in prices has been less beneficial for the knitwear industry as their inputs are more varied.

[25] The Generalized Scheme of Preferences: The greatest challenge in maximizing the benefits from Pakistan's access to this preferential tariff scheme is ensuring labour law compliance in the four provinces, and in both the formal and informal sectors, as a significant portion of global production is outsourced to contractors and subcontractors that hire informal workers to produce their output.

Figure 5.3: Pakistan's quarterly exports of garments, $ millions



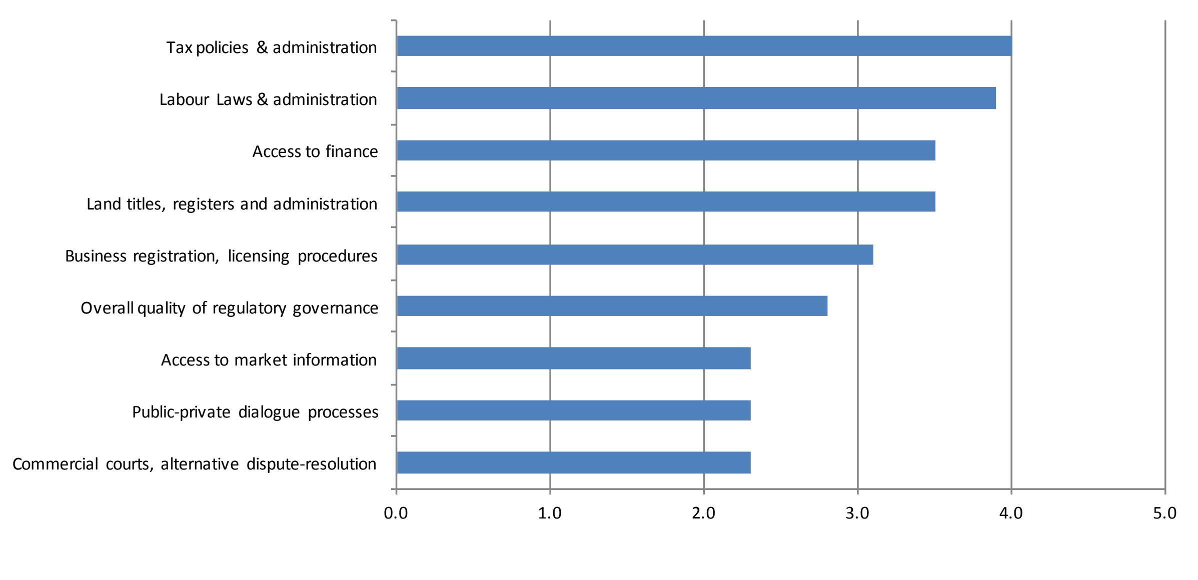
Source: State Bank of Pakistan

Overall, GSP Plus status has not boosted export performance as expected. The increase in the value of exports has been tempered by issues such as the exchange rate appreciation and increased costs due to the energy crisis.

5.2 Garments Diagnostic Section

In assessing the impact of the current business environment on BER functions, the team secured input and feedback from 11 garment manufacturers, the Pakistan Hosiery Manufacturers & Exporters Association (PHMEA) and members of Pakistan Readymade Garments Manufactures & Exporters Association (PRGMEA). Figure 5.5 below provides a snapshot of how the garments sector ranks each of the nine BER areas discussed during the field work.

Figure 5.4: BER Functions - how severe an impediment is it to business?



The data suggests that tax matters which include tax policies, tax administration, behaviour of tax officials, informal payments and the cost of complying with taxation are the most serious BER constraint for the garments sector in the Punjab. Over 50% of the firms listed this as their top most constraint. Labour laws and administration which included EOBI, social security payments and worker compliances is seen as the next most obstructive in doing business with 35% of the firms listing it as the top constraint. Finally, issues relating to land and SME credit are the next biggest constraints as perceived by the sector with again 35% of the firms registering it as a top constraint.

The next section extends the discussion of Chapter 3 by providing sector-specific details for those constraints that were seen to be particularly problematic for the garments sector. The common constraints discussed in Chapter 2 that apply equally to the garments sector are not repeated here.

5.2.1 Business Licensing and registration procedures

Sales Tax Registration

The delay in sales tax registration is most concerning for the garments sector. The garments sector includes firms that export close to 100% of their production and hence have no output sales tax, however, they do pay sales tax on inputs which is then refunded to them. FBR officials and industrialists reported instances of the private sector successfully submitting false refund requests. To avoid this, FBR now undertake lengthy checks into companies registering in this sector before issuing sales tax numbers, sometimes taking over two years.

Companies that do not have a sales tax number are unable to register with the Ministry of Textile Industry (MTI) and do not qualify for rebates, tax breaks or support grants announced by the MTI. In most of the competitor countries (Bangladesh, Cambodia) the inputs are zero rated for sales tax purposes, avoiding the risks of false claims.

Clearance from Environment Protection Agency

Exporting firms have to comply with strict environmental compliances required by international buyers. Obtaining all environmental compliances is becoming a major constraint to the garments sector. Firms complain that the Punjab Environmental Protection Agency is slow and unequipped to address the needs of the sector, forcing firms to turn to more expensive options of international certifications, as required by their buyers.

5.2.2 Tax policies and administration

Dealing with tax issues and inconsistent and ad hoc policy changes introduced by the government is the most problematic area for the garments sector. Firms reported that they were only dealing with FBR and did not interact with other agencies (such as the MTI, the Ministry of Commerce and the Ministry of Industries) as the Federal Government has been most active in altering and implementing changes in taxation. The issue of sales tax refund has been the main stay of all discussions held with the sector, however, as of 30 June 2016 FBR has temporarily allowed zero-rating of inputs for garments sector. However, the sector is sceptical about the longevity of this provision and expects that the government may reverse this decision. Such policy changes can affect businesses as they could require unplanned cash flows and make it difficult for them to plan effectively.

The interviews also revealed that FBR was releasing only small amount of payments against their refund claims. They said that FBR informed them that the remaining amounts were being deferred and would be paid after the company's audit has been conducted. This contradicted another government policy that states that export oriented firms will not be audited. Without an audit, there is no movement towards resolving the refunds issue and the matter is still pending.

Tax Compliance and Administration (Regulation & Administration)

Businesses reported that FBR's lack of understanding of garments production cycle and rigid approach to calculating taxes was resulting in penalties and false tax claims. FBR currently uses pre-defined input-output (fabric to garment) ratios for the sector. These can substantially vary between factories, particularly as some specialise in extra-large sizes and others manufacture complicated designs. Similarly, FBR uses a standard wastage rate to estimates sales tax liabilities. More efficient factories have lower wastage and are therefore receive notices stating under declaration of sales tax.

Finally, FBR has inappropriately used bank statements which include customer advances and sales tax refunds of duty rebates to estimate sales.

One SME reported that a PKR 15 million notice was served to the company by the tax office. The total penalty amount was linked to three violations. The first assessment was based on the fact that the factory was using more cloth to produce fewer jeans that were exported. FBR uses a standard conversion rate for cloth to product, however, as the company was working on a special order of extra-large sized garments for the US market they were using more input to produce fewer garments. FBR claimed that the company was not declaring all the garments made and was selling these in the local market, and subsequently came up with a figure for sales tax that was due.

Secondly, FBR estimated that the standard wastage of cloth is 6-7% which is sold locally and sales tax is to be collected on these sales. However, for this company the wastage is only 2% because of their internal efficiency controls, so a second claim was made for sales tax due on underreported sales of wastage.

Thirdly, the notice claimed that the company was suppressing sales simply by looking at credits in the bank accounts. In doing so, the estimates included all the refunds and rebates received from the government.

The concerned tax officer asked for PKR 1.5 million to settle the case. The company refused to settle and got a favourable decision from the tribunal, but still ended up spending PRK 150,000 in lawyer fees.

Issues with Imports

Certain inputs that are not made in Pakistan but are required to be imported to add value or are a conditionality from buyers attract a very high rate of tariff. A typical example quoted was where companies have to import buyer's labels as part of the final order. The labels attract a duty of 25% and there is no clarity on the refund policy for these as all are being re-exported. The customs agency also creates issues in such instances as they can sometimes say that the product is on a restricted list. Some factories also import certain types of fabrics that are then re-exported as garments. The customs agency requires an indemnity bond to be placed in the value of the import duty and some other charges. The bond is returnable if the material is re-exported within three to six months, however, factories face delays in getting bonds released and in some cases reported paying speed money.

Emerging issue of duplication of taxes by Punjab Revenue Authority (PRA) (Policy, Regulatory and Administrative)

The SME sector often sub-contracts their orders to other firms. The sector fears that, without proper policy formulation and clarity between FBR and PRA, these stitching sub-contacts will be classified as services by PRA and face tax duplication, as discussed above in Section 3.2.1. The industry feels that such uncertainty must be removed before the negative impact becomes a binding constraint on the industry.

5.2.3 Access to finance

Banks have recently increased their risk ratings for the textile and garments sector and are restricting new loans and reducing existing limits. Despite this, some of the very large players are still able to obtain loans easily and at favourable terms.

The State Bank has a Long Term Financing Facility for capital upgradation at reduced rates of interest. However, the textile and garments sector (especially SMEs) are unable to tap into this pool at the moment.

5.2.4 Labour laws and administration

Minimum Wage, EOBI and social security payments

Industry raised strong concerns regarding the minimum wage laws, both in terms of the amount of minimum wage and the application of the law. In terms of amount, the respondents felt that PKR 14,000 was an extremely high wage for a low skilled worker in the garments industry as there are so many of them employed and requirement of skill is fairly basic. They claimed that although they understood that from a social aspect this amount was still small to manage living expenses, that it was important to realise that the market clearing wage was much below this mark in the sector, and hence industry was unable to afford this price. This, they claim is a classic example of how limited thought goes into government's policy making.

Garments industry employs workers both on piece rate and on full time salary. The minimum wage policy does not take into account this employment model. For example, minimum wage of PKR 14,691 per month is to be paid to a 'Skilled-A' worker for working 26 days a month. At the same time, piece rate working is also allowed. However, the law does not state what happens if the piece rate worker earns less than the minimum wage.

5.2.5 Overall quality of regulatory governance

Some larger international buyers, such as H&M, have started the Sustainable Apparel Coalition and are assessing compliance based on their agreed standards. This has generally made garment factories cleaner and encouraged investment by owners into improving working conditions. However, lack of support and discouraging behaviour of the environment authority in Punjab is a big hurdle in the way of meeting these targets.

The garments and textile sector remains unregulated for quality standards. PSQCA has no role within or standards for the local industry. Some of the very large units are making use of banned chemicals for colouring and dyeing fabric and garments to be sold in local markets, and have faced no checks at all. PSQCA has limited its role to the food industry, without acknowledging that having standards and ensuring compliance is equally important across all industries.

5.2.6 Land titles, registration and administration

Garment clusters in Lahore have emerged over time in an unplanned manner and consequently are now located in a few spatial locations. However, most of these localities have been converted into dense residential and commercial areas. So these pockets of factories find themselves now on pieces of land that are not notified for their industry. To address this issue the GoPb has been strongly pushing for a new apparel park, and will be giving some incentives for factories to relocate. The sector is looking keenly forward to the launch of the Quaid-e-Azam Apparel Park as that will address most of the land related and other general BER issues, however, at the same time feels sceptical because of the Government's historic performance.

An SME interviewed procured land near the village Laliyani that is 200 metres off of Ferozpur Road. The land was transferred and the registry was complete. The company wanted to start construction, so it submitted the file for approval to LDA with design maps and all the requisite information. LDA rejected the application on the grounds that the land falls in a military sensitive area. The business asked for clarification and was told that their application was inadmissible as policy states that any land that falls within 15 kilometres of the border is considered sensitive, and no commercial or industrial activity can be allowed there. The company pointed out to LDA that Ferozpur road is only 12 kilometres from the border and yet there is a host of commercial and residential activity on either side of the road. LDA had no response to this and the case remains pending.

5.2.7 Access to commercial courts and to alternative dispute-resolution mechanisms

PHMEA and PRGMEA are the two key associations in the apparel sector and both have been involved in dispute mediations between members, with their verdicts usually adhered to. Disputes tend to relate to the SME segment, where there is a high degree of sub-contracting, leading to issues such as leaked designs and mismanagement of orders. However, as explained above, this mediation is informal and relies on peer pressure rather than a legal backing.

5.2.8 Public-private dialogue processes

PRGMEA and PHMEA are strong and influential advocates for the sector, and act as a good platform to engage with government on policy at the federal and the provincial level. Both associations have been vocal and on the issue of sales tax refunds, and secured a zero-rating on inputs from the government. This dialogue, however, is issue based and reactive in nature. Businesses believe that PPD should be proactive and forward looking. In order for that to happen, there must be a forum with formal legal status and influence on policy formulation and implementation.

The PPD Unit (discussed in Section 1.2.8, above) is expected to have a thematic working group on Industry and Trade.

5.2.9 Access to market information

The sector feels that they are deprived of any information on non-traditional markets. Any new entrant into the industry naturally focuses on the US and the EU market as information is available with ease. The new entrants fail to realise that these markets are more challenging both in terms of standards and pricing as there is stiff competition from Bangladesh, Cambodia, India, China and Vietnam. TDAP a lead agency only arranges exhibitions to traditional garment markets and to date have failed to provide any research information on newer markets where entry costs are low. Also, PREGMEA stated that they have been knocking on several doors to assist them in compiling information on the details of garments sectors in key competitor countries, but to date no department including PBIT have been able to facilitate them in accessing this information.

Gender Specific BER Issues for Garments

Garments is one of the very few industrial sectors in the country that have a high share of women in the workforce. The stitching machine operators in most of the modern factories are women. One issue highlighted by industry was that labour laws prohibit women from working the late shift. This creates difficulties for an industry which operates on three shifts due to limited capital deployed. Of the twelve factories that were interviewed during this exercise, one factory started off with a 100% female workforce, but were not able to recruit enough women and experienced a high turnover rate due to social and cultural pressures associated with marriage. Industry remains divided, some still feel that female workers are easier to train and retain.

None of the 12 firms interviewed had female CEOs, however, there are local brands that are run by female entrepreneurs. The key BER issue remains where women entrepreneurs stay less represented in industries power circuits. They hardly have access into government and ministries and in some cases avoid going to such places and consequently lose on benefits that the associations seek for the members. In local brands, especially high fashion garments, women have managed to produce very strong brands, such as Bareeze. There was no clear evidence that women suffered disproportionately from BER issues, although other work has argued that corruption and extortion (such as labour or environmental inspections or the withholding of taxes) exacerbate gender inequalities.

5.3 Review of regional/international best practices

This section provides a synopsis of key BER related reforms that have contributed to the success in some of the leading garment manufacturing countries.

5.3.1 Bangladesh

Bangladesh is performing exceptionally well in international garment markets due to its cost advantage in nearly every product category. Its low labour costs appear to make up for shortfalls in meeting buyers' desired criteria in other areas.

The garment sector has benefited from a number of tax incentives. These included the bonded-warehouse system, under which 100% export-oriented firms are allowed to import inputs at zero duty, rather than to use the Duty Drawback Scheme where they have to wait for refunds of customs duties and sales taxes paid on raw materials used in the production of exported goods. Exporters who were not able to benefit from the bonded warehouse system or rebates from duty drawbacks were given cash subsidies of around 10-15% of the export value against the imported inputs used. Factories based in one of Bangladesh's eight export processing zones (EPZ) also had their import tariffs eliminated, although EPZs account for less than 10% of apparel exports.

As well as tax subsidies, the Government introduced back-to-back letters of credit, which allowed garment exporters to use export orders as collateral to obtain credit for intermediate imports.

International brands have recently established the Accord (mostly European brands) and the Alliance (mostly US brands) to conduct structural and fire-safety audits in factories. The ILO has also built the capacity of public inspectors and government agencies, and coordinates the efforts of Accord, Alliance and the Government to develop a common standard for building and fire safety inspections.

5.3.2 Mauritius[26]

The Mauritian garment sector achieved substantial transformation as a result of key government policy changes. These included institutional support for promotion, innovation and productivity improvement, an exchange rate policy, private sector inclusion, and sharing of costs for adoption of new technology.

The initial growth of the textile and clothing sector during the 1980s was the result mainly of an inflow of investment from the Far East that was attracted by low cost labour and preferential, quota free access to the EU and US markets.

During the 1990s, labour costs increased as a result of a tight labour market characterised by an unemployment rate of less than 3%. The garment sector shifted from middle-market segments to more fashionable items with a more significant design input.

Various publicly funded institutions have been set up over the years as facilitators, including the Mauritius Export Development and Investment Authority (1984), the

[26]https://assets.publishing.service.gov.uk/media/57a089dfed915d622c000435/60970_Bangladesh_garment_sector_essays.pdf

Industrial and Vocational Training Board (1989) and the Export Processing Zones Development Authority (EPZDA, 1992).

Private sector involvement was achieved through the presence of its representatives on all the boards of directors of the parastatal bodies, usually as chair.

5.3.3 India

India ranks second in South Asia in terms of value and global market share (5% in 2015); although, unlike in Bangladesh and Sri Lanka, apparel's share of total exports is quite low at 5%. FDI has played a limited role (less than 1% of investment) in the textile and apparel industry.

India has been managing an active policy to develop industrial parks with a lot of focus on garments. As of November 2014, the government has invested a total of US$ 21.96 million for 21 new textile parks, and the remaining 13 textile parks have been given the in-principle approval under SITP. Furthermore, India has 199 operational EPZs, of which seven are specialised in textiles and apparel.

A number of other tax incentives and subsidies have been introduced. These have included the DBK (drawback) system, where duty is paid up front, and exporters apply for a drawback. Problems arise, however, because the drawback is calculated on the cost of materials less the amount of duty paid, and no drawback on trim items is permitted. Furthermore, tariffs plus additional import duties of 25 to 30% make FOB prices for garments uncompetitive. Overall, these amounted to a US$ 900 million package to boost textiles and garment industry in India, of which 95% is for an additional 5% duty drawback for refunding state levies. The Advance license scheme (ALS) eliminates duty paid on imports used for export production.

Companies can access credit at reduced rates through the Technology Upgradation Fund Scheme. The Government also made the decision to incentivise textile and apparel firms to absorb more labour by offering to pay a portion of the Employees' Provident Fund for new employees.

5.3.4 Cambodia

Cambodia's garment industry is a small but increasingly important producer of inexpensive clothing in Asia. The US$5 billion-plus industry employs 500,000 workers, accounts for around 80% of Cambodia's exports and is the country's main source of foreign currency.

In only ten years, the country's share of garment and footwear exports worldwide has increased rapidly from 1.1% in 2005 to 1.8% in 2014, making Cambodia the eight largest garment and footwear exporter by market share.

Garment manufacturing enterprises in Cambodia mainly operate with foreign capital from areas such as China, Hong Kong, Taiwan and South Korea. Most raw materials of garments and footwear are imported from Asian countries, especially from China, Japan and South Korea. Cambodia garments factories can manufacture garments with techniques of washing, tie-dyeing and embroidering, but still lack dyeing and finishing skills.

Exporting industries have been supported by a number of tax incentives, including the exemption of all duties and VAT. The garments, footwear and supporting sectors also benefited (until 2010) from reduced social security contributions. A monthly advance profit tax (1% of turnover) was suspended from 2015.

Cambodia also has some well-developed institutional mechanisms to resolve collective action disputes and other issues of concern in the garment sector. Formal settings of public-private dialogue are relatively well institutionalised, allowing the Government to reflect the views of industry in the development of sectoral policy. The tax relief and trade facilitation measures in the garment sector emerged out of precisely this type of process.

5.3.5 China

Between 2000 and 2012, China's share of global apparel exports increased from 25% to 41%. However, as China continues to develop, it is likely to either move up the value chain into higher-value goods (and out of apparel), or be subject to production shifts in response to its higher wages, which may create opportunities for other countries including Pakistan.

The sector grew with a strong government emphasis on regional clusters in different products. According to China National Textile and Apparel Council, there are 146 major apparel clusters in China, concentrated in the coastal regions.

This has been coupled with substantive institutional support, including favourable tax reductions, export subsidy and internal property rights policies. The threshold for private enterprises to be listed has been lowered to help private enterprises overcome the financial difficulties. Government assistance can also be found in the "Opinions to further support the healthy development of small and micro enterprises" (No. 14 documents) and "Provisional view on providing financial support to small- and micro-enterprise" (No. 87 document), with the former seeking to nurture the development of innovative, ventures, and labour intensive firms, and the latter reducing firms' financial burden to enhance sectoral performance.

China set up "China Environmental Management System Certification" to complement the implementation of ISO 14000 and improve the environmental impact of the production process. Meanwhile, the internationally recognised Oeko-Text Standard

100 provides environmentally friendly certification to export business meeting defined criteria standards. This helped firms in upgrading their production techniques, as well as capturing the international market.

5.3.6 Conclusions from international best practices:

One of the key issues faced by the garments sector is related to administration and refund of sales tax. The industry feels at a loss when they have to spend resources to manage cumbersome withholding procedures, maintain records, and then face delays and penalties in obtaining their refunds. Most of the competitor countries have allowed zero-rated sales and duties on inputs into the garments sector. India, Bangladesh and Cambodia are specific examples. Vietnam does not strictly have a zero-rated policy, however, tax refunds are cleared within 10 days of submitting the returns.

The discussion above also shows that the garments sector prosper when they are clustered together and benefit from common facilitation. Consequently, all the regional competitors considered have supported their garments sector by re-locating industry into special parks where one window facilitation for business registrations, export import licences, clearing, labour issues and other compliance matters are dealt at single window.

The regional best practice analysis also suggests that countries such as India and China have provided special packages to support the credit needs of SMEs within the garments sector. Both countries have run targeted schemes to improve access to credit on terms that suit the development requirements of small businesses. Finally, policies of the benchmarked countries show that a lot of support is being provided for factories to become environmentally compliant. This has resulted from the increasing demand from high end buyers for factories to comply with stricter standards. It is imperative that developing countries like Pakistan begin to invest early in meeting these standards, or else it will become increasingly difficult to compete.

The table below provides a summary and cross-country comparison of key constraints faced by firms in Punjab and Pakistan.

Table 5.2 Punjab/Pakistan Compared to Other Countries		
Area	**Punjab**	**Competitor Countries**
Sales Tax	Cumbersome process of refunds, delays in payments	Mostly '0' rated (India, Bangladesh and Cambodia, Vietnam takes 10 days for refunds
Clustering	Industry mostly scattered, some industrial estates but no economies to relocate	Strong incentives (tax rebates, free or cheap land, one window facilitation, customs, connectivity, labour issues, skills) provided making it attractive for firms to relocate
Credit	No dedicated credit lines for the sector, in fact at the moment is considered a non-lending sector, No SME development financing products	Strong credit support available for industries to expand or purchase technology.
Environmental Compliance	EPA Punjab is unhelpful and have limited capacity, moreover the infrastructure is inadequate and increases cost of complying with environmental standards	Significant investments made to upgrade infrastructure and also to support firms in becoming environmentally compliant to international requirements

5.4 Recommendations

5.4.1 Quick wins – Garment specific

Tax Policies & Administration

It is important for the new firms entering into the garments sector to get their registration with MTI. The reason being that those industries that are not registered with MTI cannot apply for TDAP trade facilitation exhibitions, cannot benefit from facilitations given from export development fund and also any special programmes that are announced by the ministry. However, at the same time, it is equally critical for FBR to assess the nature and genuineness of the applications in order to avoid false refunds on sales tax. It is recommended that provincial governments should advocate with MTI to allow for a provisional registration (duration maybe be agreed with Ministry and based on average time it takes to get Sales Tax) with MTI based on the sales tax registration application number. This way the companies will not be deprived of any support provided by the ministry and FBR can fully assess the nature of the application and make a fair decision. The Provincial Government should advocate for these through Punjab Investment Climate Reform Authority (PICRA).

Another issue that continues to hamper the performance of the garments sector is ad hoc changes in tax policies. The industry works on advance export orders and hence factors in taxation in order to calculate their cost and price quotations to clients.

Unanticipated changes and reversals in the policy distort these calculations and in some cases result in industry losing out on orders. Since 1 July 2016, FBR has announced input sales tax to be zero rated for the garments industry. However, the industry is sceptical on the duration of this incentive. It is recommended that FBR should commit to a duration of the zero-sales tax on inputs.

Labour Laws & Administration

The industry feels harassed by labour inspectors and mostly find themselves disagreeing to social security and EOBI contributions calculated by labour inspectors. This conflict is usually resolved by making informal payments, hence on one hand the industry bears intrusion while the government is not necessarily receiving all the payments made. Labour Department may work with FBR and introduce a fixed charge of x%[27] (Bangladesh has it between 0.2-0.3% of exports) of the annual export turnover for garments sector (MTI registered exporters) as the full and final payment for EOBI and social security. For firms that are paying EOBI and social security as a percentage of their export turnover, it will be their full and final payment and disclosure. Moreover, no EOBI or social security inspectors be allowed to enter the premises of these firms. A similar policy has been in place in Bangladesh. (Industries Department/Labour Department GoPb to advocate with federal government)

5.4.2 Medium to Long Term – Provincial Government interventions – sector specific

Business Registration & Licensing, Land Titles & Quality of Governance

Regional best practice analysis shows that governments of key competitor countries have relied on dedicated industrial zones and parks to consolidate industry as clusters, and then provided sector relevant support and one window facilitation. The garment industry in Punjab, like most of the other industries, is fragmented and has cropped up in residential and commercial centres. This has resulted in industry facing issues of land titles and registration, labour records and labour compliances, environmental compliance and other issues relating to poor quality of governance. It is realistic to assume that issues such as land titles and land records, dealing with LDA for permits, reforming the EOBI and social security as a whole, providing adequate infrastructure generally across the board cannot be addressed in the medium term. However, if industry is clustered at a specific location then these issues can be addressed as a special case in isolation. Consequently, Quaid-e-Azam Apparel Park is being eagerly

[27] PREGMEA stated that this could be between 0.1-0.2%. The exact policy rate may be worked out by looking at existing contributions made by the sector.

awaited by the sector and they have high hopes that this will resolve most of the BER issues listed below as they fall under the remit of the provincial government. The Park Authority should have adequate representation of the garments industry and it should work with various provincial department to ensure that:

- All business registrations and issuance of National Tax Number (NTN), Sales Tax Number (STN) and registration with MTI are provided as a one window operation.
- Register and facilitate labour that will be allowed to work in the park and maintain records of units employing these workers. This can then be used to assess all labour related payments and issues.
- Provide swift transfer and planning of land, with clear title of ownerships and terms and conditions.
- Provide suitable infrastructure to support firms to comply with environmental standards and compliances. Support industry and certification agents may be allowed to set up offices for facilitation of businesses.
- Assist in establishing a formal platform to provide business and market related issues, and collaborate with PRGEMA and PHMA to establish formal mechanism of policy dialogue and lobbying with the government.

As the authority is being established the provincial government may commission of industrial mapping of garments sector at Ferozpur Road and Kamahan and bifurcate a specific area to be declared a garments zone.

Provincial Government to Advocate with Federal Government

The sector feels that FBR implement policies and administrative procedures that do not take into account the business model of the garments sector. The diagnostic section provided a discussion on this. For example, FBR overestimates sales of wastage and also use a rigid formula to determine input – out ratios. To address this FBR may run training programmes for its staff to better understand business model of the garments sector so that they are able to deal with specific issues of sales tax registrations and refunds affecting the garments sector.

One of the reasons why the garments sector prefers exports to domestic market is lack of quality standards and compliance requirements. Firms that are willing to produce quality products feel at a disadvantage at the hands of low quality producers. This severely impedes competition. This results from an absence of a regulatory body that is responsible for determining the quality, safety and compliance of the products in local markets. Moreover, as there are no quality checks required there are no local certifying and testing firms in the sector. This implies that firms have to import such services which greatly enhances the costs. There is need to establish a body or expand the scope of PSQCA. The compliance criteria can be linked to key international certifications that will address the issues of governance and corruption.

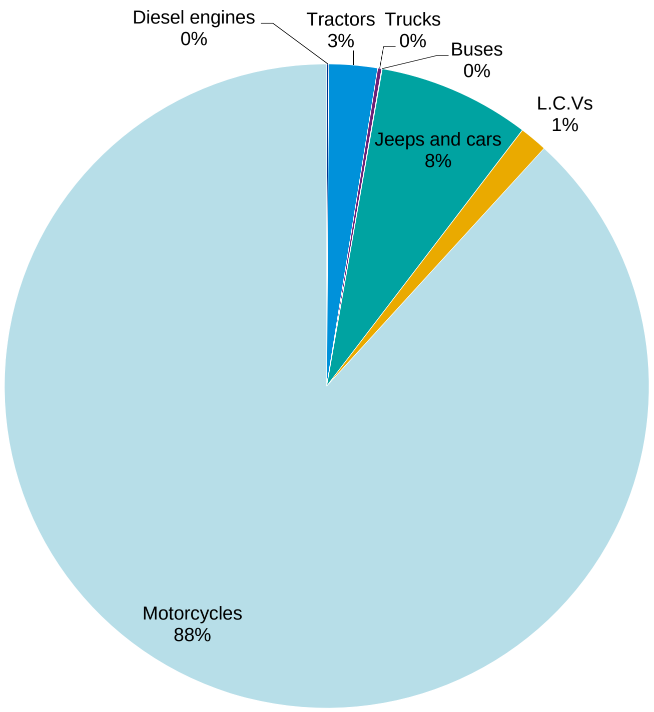
Finally, State Bank should develop and implement specific credit schemes that suit the needs of the garments sector. One such example is credit based on back to back LC for exports, as it is a major product that is used by garment manufacturers in Bangladesh to secure credit. PBIT should lead this advocacy with the State Bank.

6. Automotive

6.1 Automotive Overview

The auto sector represents 16% of the manufacturing sector of Pakistan, contributing US$6 billion to the national economy and employing 200,000 people.[28] Approximately two million motor vehicles are produced annually, comprising largely motorcycles (1.7 million units) and cars (153,000 units). Pakistan also produces 49,000 tractors and over 28,000 light commercial vehicles a year.[29]

Figure 6.1: Share of sales volumes by type of vehicle, 2014-15



Source: Engineering Development Board 2015

[28] Ahmad and Batool (2015). Employment figures are industry estimates.

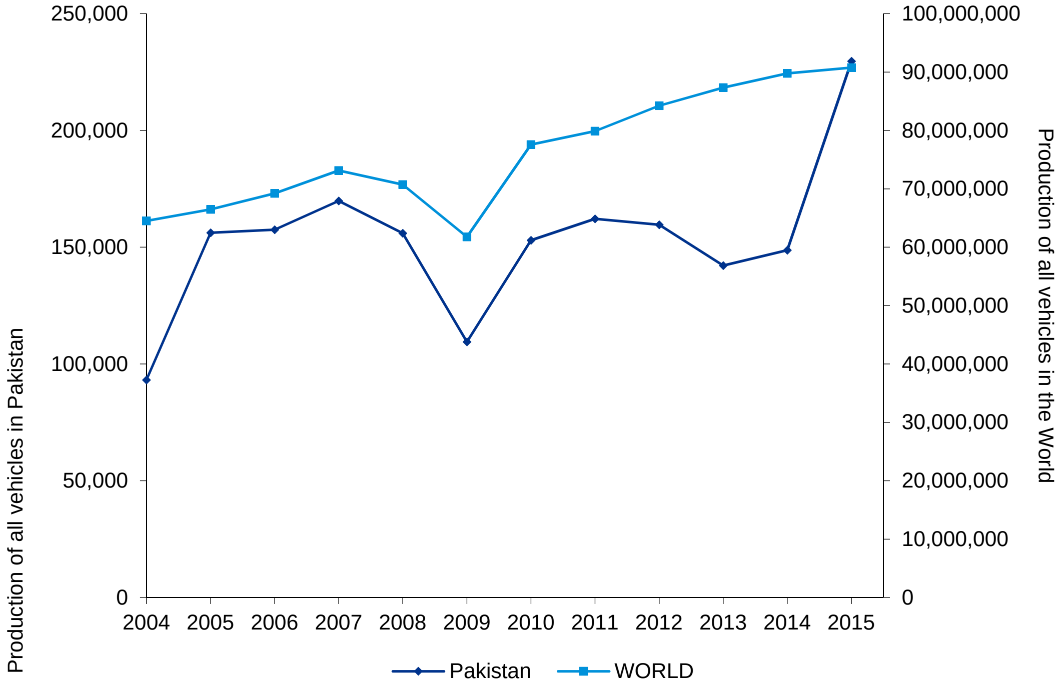
[29] Data from the Engineering Development BoardBroad of Pakistan

Much of the auto sector in Pakistan is based on collaborations with multinational firms. The three passenger car manufacturers are all collaborative ventures with Japanese firms that have a global presence in the auto sector (Toyota, Honda and Suzuki). The two tractor manufacturers also have linkages with multinational firms - Millat tractors manufactures under license from Massey Furgusen, and Al-Ghazi is a technical collaboration with Case New Holland. Similarly, in the commercial vehicle sector, Hinopak Motors is a collaboration between Hino Motors Japan and Toyota Tsusho Corporation, and Master Motor Corporation Limited produces for Chinese firms Foton and Yuejin. The motorcycle sector has the highest number of indigenous assemblers, although, here too, Honda Atlas, the collaborative venture with an international firm, has the largest market share (40% market share in a market of 70+ motorcycle assemblers). Similarly, many of the auto parts manufacturers, particularly those that produce for the domestic OEMs, produce under technical collaborations and licenses from global auto parts manufacturers. Afraz et al (2016) document over 100 technical assistance agreements and collaborations with foreign firms in the auto parts sector.

Growth in the auto sector therefore has the potential to directly improve linkages with multinational firms and FDI. In addition, the auto sector is widely recognised as a "mother industry" due to high economic spillovers, leading to increases in employment and income, and improvements in engineering capacity throughout the value chain.

Production volumes in the auto sector in Pakistan have increased sharply since 2014, with growth that has outstripped the world growth rate, as shown in Figure 6.2. This trend is expected to continue, with the announcement that Renault will start production of cars from 2018, and with the continued boost to the production of heavy commercial vehicles due to China-Pakistan Economic Corridor (CPEC) related demand.

Figure 6.2 Vehicle production in Pakistan relative to global time trend



Source: OICA 2016

The auto parts sector, which is a derived demand of these vehicles, services the domestic value chains of the local vehicle manufacturers and also caters to replacement markets in Pakistan and abroad. This sub-sector comprises approximately 2,000 manufacturers specialising in a range of production technologies such as plastic injection moulding, forging, casting and sheet metal.

The auto parts sub-sector has been selected strategically as the focus for this chapter, as it presents the most substantial potential as compared to the other sub-sectors (which comprise the various types of vehicle manufacturing summarised in Figure 6.1 above). The auto parts sub-sector already has inroads into export markets, and there is a possibility of fitting products manufactured in Pakistan into global value chains (GVCs). While Pakistan has achieved economies of scale in motorcycle manufacturing, the market is dominated by the 70 cc motorcycle, which has a low and shrinking demand in other parts of the world. The passenger car sub-sector is both small scale and not globally competitive, and the remaining sub-sectors in the auto sector all produce fewer than 50,000 units each. Therefore from the perspective of volumes and export potential, the auto parts sub-sector provides opportunities that are greater than those for other sub-sectors: cars, motorcycles, tractors and commercial vehicles, which makes it a useful case study within the auto sector for this report.

While the auto parts sub-sector has made inroads into export markets, the parts exported are mainly for niche and replacement markets. Furthermore, as illustrated in Figure 6.3, Pakistan has been losing global market share in the growing international auto parts sector. In 2015, total automotive exports were just US$45 million (down from US$60 million in 2014), of which US$17.4 million came from auto parts (down from US$23.7 million in 2014).[30]

Figure 6.3 Export value of auto parts (HS8708)

Source: UNCOMTRADE

Since the demand for auto parts is a derived demand for the demand for vehicles, the uptick in domestic demand illustrated in Figure 6.2 can be expected to boost demand for domestic auto parts with a time lag. Economies of scale can be achieved through

[30] Source: UN Comtrade data using HS87 for the automotive sector as a whole, and HS8708 and HS8714 for autoparts. The other major contributor to automotive exports besides autoparts was tractors (HS8701).

this expected increase, along with the potential of supplying to Chinese OEMs following the recent improvements in logistics due to the CPEC.

Car production is now organised in GVCs rather than undertaken in one country. Lighter, higher value parts (such as engine parts) are typically sourced from the most competitive producer globally, net of transport costs. Large and heavy parts (such as car body and car seats) are manufactured close to the final sales point. Auto parts producers that manufacture for GVCs benefit from the large volumes that allow them to attain economies of scale. The parts produced in Pakistan are not yet part of the *global* value chains of Original Equipment Manufacturers (OEMs), even if they supply the *domestic* value chains of the local OEMs in Pakistan (Toyota Indus, Pak Suzuki and Honda Atlas) and replacement markets abroad. So, for example, Thal Engineering Ltd manufactures thermal systems for Toyota Indus, for use in the cars that are assembled and sold in Pakistan, but to qualify as a GVC supplier, Thal Engineering Ltd would have to be supplying thermal systems to Toyota in other countries too.

The development of the domestic value chain can be ascribed to the deletion policy that Pakistan has followed till 2003, whereby these OEMs were allowed to manufacture in Pakistan on the condition that they source a certain proportion of their parts in Pakistan within a specified time. Even though the deletion policy has now been discontinued, Pakistan continues to offer a high level of tariff protection to local auto parts suppliers, and this remains an important reason that the local OEMs continue to source many of the parts from Pakistani manufacturers.

Another important feature of the Pakistan auto parts segment is that auto parts producers are currently manufacturing based on blueprints provided by technology partners or OEMs. This is a low value added process compared to the higher value addition processes of designing, branding and R&D.

Although the auto parts produced in Pakistan are not part of global GVCs, many have established linkages, such as technical collaborations and joint ventures, with global Tier 1 multinational suppliers[31] such as Denso. This suggests that they are at an early stage of development. Other top auto parts manufacturing destinations, such as Taiwan, also started with exporting replacement parts for American and Japanese old car models, and matured to GVC supply.

[31] Tier 1 companies are those companies that supply the vehicle manufacturers directly. Most Tier 1 companies are themselves global firms, manufacturing in several countries. Tier 2 companies are those that supply the Tier 1 companies.

Becoming GVC suppliers is an important next step for auto parts producers. GVCs would provide the large volumes to local producers to help them achieve economies of scale, and therefore would be a very important vent for Pakistan, given the small scale of the domestic market. Secondly, Tier 1 multinational suppliers typically collaborate closely with the carmakers (who are multinationals themselves) and participate in R&D and innovation. These linkages give important benefits, particularly improving technology and innovation, throughout the value chain. The auto industry files 12% of all patents worldwide, which makes it one of the top three most innovative industries in the world.[32] Therefore, potential technology spillovers that upgrade domestic value chains are particularly relevant for the auto sector.

There are several prerequisites to be part of a GVC: close proximity to a large final market and seamless trade flows, competitive prices for the specified quality, and a business environment that is attractive for foreign investors and supports technical collaborations.

Pakistan is geographically ideally placed for GVC integration, sharing a border and good trade relations with the world's largest motor vehicle manufacturer, China, which produces over 21 million cars a year.[33] Rising labour costs in China provide Pakistan an opportunity to produce labour intensive parts more competitively. However, regional competition is intense: India, China, Thailand and Taiwan are all global leaders in auto parts. For GVC participation, Pakistan's auto parts producers will need to demonstrate better value and reliability that these competitors.

On logistics, Pakistan performs better on the World Bank Logistics Performance Index (LPI) than the regional average and the average for its comparison income group, though lower than the region's best performer, India. Logistics have already improved with the China-Pakistan Economic Corridor (CPEC) and related investments.

Business environment remains an important binding constraint for the auto sector, and this forms the context for the selection of the sector for this report.

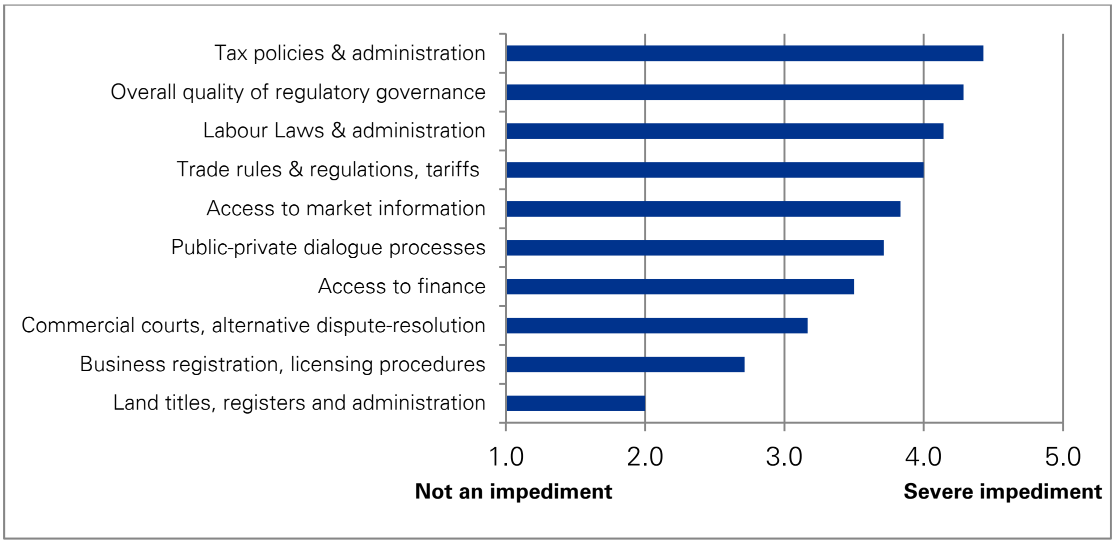
[32] Thomson Reuters (2016) "The State of Innovation" available at http://stateofinnovation.thomsonreuters.com/

[33] Data source: Organisation of Motor Vehicle Manufacturers (OICA) 2015

6.2 Automotive Diagnostic Section

Seven auto parts firms and the auto parts association (PAPAAM) were interviewed for this section. Each of the BER functions was discussed in detail, and at the end, the respondents were asked to rank the BER functions in terms of how severely their business is impacted. Each BER function was ranked on a scale of 1 to 5, where 1 indicates that the function is not an impediment and 5 indicates that it is a very severe impediment. Figure shows the average severity reported for each BER function. The top three binding constraints appear to be tax policies and administration, overall quality of regulatory governance and labour laws and administration.

Figure 6.4: BER Functions - how severe an impediment is it to business?



Source: Interview data

These results are consistent with the qualitative assessment of each BER function discussed in detail below.

While firms reported problems with all the BER functional areas, some of these problems could be circumvented, and while they had a nuisance value, they did not disrupt business substantially. Others were major obstacles that prevented growth and investment in the sector.

This section extends the discussion of Chapter 2, by providing sector-specific details for those constraints that were seen to be particularly problematic for the auto sector. The common constraints discussed in Chapter 2 that apply equally to the auto sector are not repeated here.

6.2.1 Tax policies and administration

All of the firms interviewed in the auto sector ranked tax policies and administration as one of the top three BER constraints, and 43% of them ranked this as the biggest constraint.

Tax policies are poorly planned

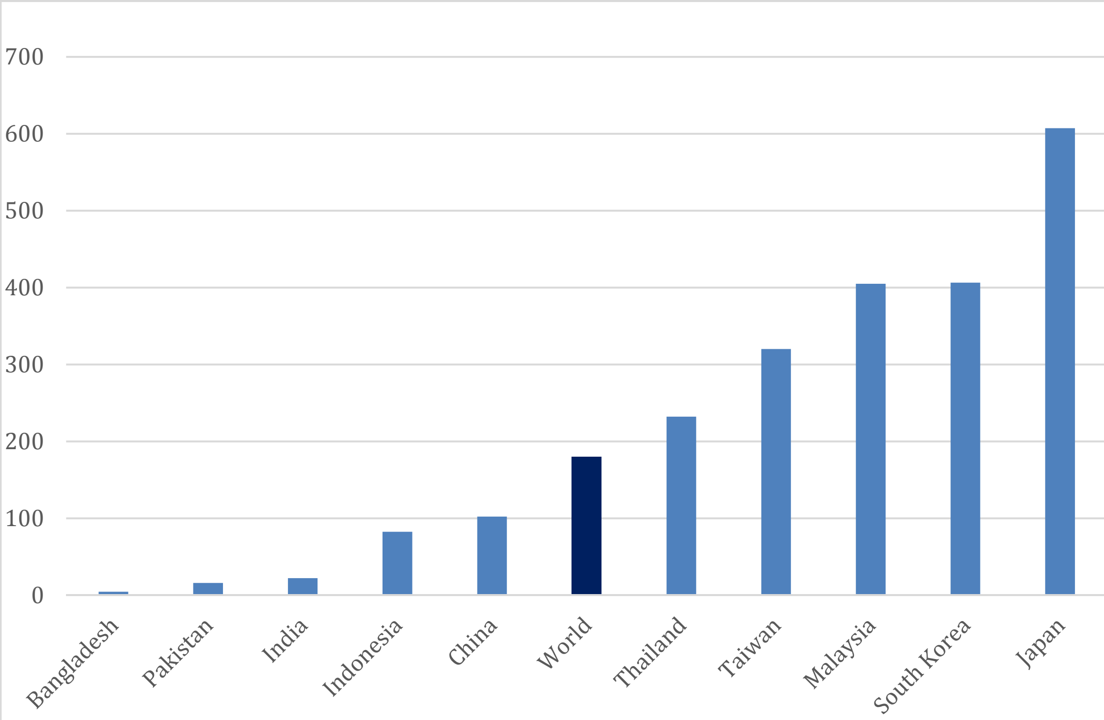
Auto parts manufacturers credit their initial expansion to an integrated policy approach that is no longer followed. This included tax breaks for starting industry in a defined radius band around Lahore, together with subsidised credit for farmers to buy tractors and for auto parts manufacturers, inexpensive land in industrial estates and deletion policies that required OEMs to source parts locally. The integration of tax policies with these other interventions created an enabling environment under which the auto parts industry developed.

The current set of tax policies for the auto sector is seen to hinder the expansion of market size and of investment. For example, a natural direction for the Pakistani auto market is the development of the small car segment (800cc), which is currently only served by Pak Suzuki. A small budget car is the next step for a household with a motorcycle, as household income improves. Having a high sales tax[34] on this category of small cars raises the cost of purchasing the car and inhibits the expansion of market size. Pakistan has one of the lowest vehicle ownership rates in the world, as shown in Figure 6. In the region, only Bangladesh has a lower motorisation index, with 5 vehicles in use per 1000 inhabitants.

> An SME interviewed said "If you (FBR) step into a business and you have a feeling that things aren't going so well; there are problems. What should their attitude be? The government should try to float the business and keep it viable. But they say: we don't care, you have to deposit the taxes."

[34] Sales tax in Pakistan is 17%, which applies to all cars. In addition, advance income tax is collected on purchase of a car. The provincial Excise and Taxation department also collects token tax and professional tax every year. Details are available at http://www.excise-punjab.gov.pk/motor-vehicles-tax.html

Figure 6.5: Motorisation rate (vehicles in use per 1000 inhabitants), 2014



Source: OICA 2016

The Automotive Development Policy (ADP) 2016-21 sets volume targets for all sub-sectors of the auto sector, yet, the only incentives appear to be related to the tariff structure on imports, and that too, only for new investors. Tax policy should support industrial policy objectives, and recognise that expansions in market size due to lower taxes would lead to increased output and employment, and eventually to higher tax revenues for the Government.

Frequent ad-hoc changes to tax policies, including customs and regulatory duties, are particularly damaging for the auto industry as it requires very large investments in plant, machinery and technology, and firms have to plan their volumes and costs for several years ahead. Frequent change disrupts this planning, and discourages and delays the introduction of new technology and new models.

For example, changes in tariffs on imported inputs change the costs of the product manufactured, and is especially harmful if that change has been made without prior notice. The ADP 2016-21, which laid down a five-year tariff plan for the auto industry, was approved in March 2016. Immediately after that, regulatory duties on various metal products were introduced, and in April 2016, regulatory duty for steel imports was introduced in order to protect the local steel industry. The unintended consequence was that the tariffs paid on the imported inputs by auto parts manufacturers substantially diverged from those tabled in the auto policy, even if those products and steel grades that they use are not made locally, and therefore are not in competition with local steel. Ad hoc changes such as these increase uncertainty and make investments more risky, which deters investment, particularly FDI, in the sector.

An SME interviewed said "They change this taxation process every few months. It is so cumbersome. You need a professional to do this, no layman can do this. We have hired two people for this."

6.2.2 Overall quality of regulatory governance

43% of the firms interviewed reported that the quality of regulatory governance was in the top three BER constraints that they faced.

The auto sector is not regulated by a specific regulatory agency

There is no specific regulatory agency for the auto sector in Pakistan. National quality standards only exist for two-wheelers, and even for those, while the PSQCA has specified standards, there does not exist the requisite capacity to test and enforce the standards properly. OEMs self-regulate to their global minimum standards and ensure that auto parts manufacturers which are part of their value chains are also compliant to those standards. The lack of nationally specified and enforced quality standards is highly unusual for a country with a domestic auto industry.

There is no consumer protection watchdog exclusively for the auto sector, despite a high level of market concentration in the car, motorcycle and tractor sectors. There have been Competition Commission investigations in the auto sector to ascertain anti-competitive behaviour, but the findings have not been conclusive. There is widespread belief that the OEMs exploit their market power, both with customers and suppliers, but there has been no substantive study to support this claim.

Some general regulations that the auto parts industry has to comply with are shared with other manufacturing firms. As discussed above, environment regulation and dengue controls were singled out as particularly problematic.

6.2.3 Access to commercial courts and to alternative dispute-resolution mechanisms

Businesses in the auto parts sector prefer to settle their cases out of court, using common contacts or the auto parts association (PAAPAM) to assist in exerting peer pressure.

In contrast to the commercial courts system, PAAPAM is a useful and effective organisation through which disputes have been settled. Grievances, such as money owed to auto parts suppliers, have been dealt with using peer pressure and collective action. This can be in the form of a joint representation that tends to be taken more seriously than individual complaints, although PAAPAM has no legal mandate to enforce decisions. Similarly, suppliers who were owed money by a particular bankrupt firm recently formed a consortium and took over the bankrupt firm. For minor issues at least, PAAPAM is effective in helping resolve conflict, though the lack of legal cover means that more fraught disputes are unlikely to be resolved.

6.2.4 Public-private dialogue processes

Businesses have access to policy makers, but the consultation process is not systematic or easy

Businesses do feel that they have access to policy makers, and are asked for their inputs for some policy decisions and are also consulted before the budget. Coordination is done via PAAPAM, and auto parts manufacturers felt that this was an effective body to voice their concerns. However, there is no guarantee that policy issues will be resolved at all, or will be resolved in a timely or systematic fashion. Furthermore, the sector is perceived to be prone to lobbying. Once a decision has been taken, another lobbying group could lobby for reversal, and this has in the past led to fluctuating customs duty rates, sales tax, used car policies etc. which impedes investment planning. The auto sector has a history of frequent policy changes - PAAPAM has documented 30 policy changes that were made during the period covered by the previous announced ADP (2007-12), despite there having been a policy in place.

The policy making process is perceived to be dominated by FBR and the Ministry of Commerce, which stakeholders believe are not the correct policy making agencies for the auto industry. It should instead be the Ministry of Industries, which is able to take decisions that are based on industrial development.

Gender Specific BER Issues for Automotive

All firms interviewed had male CEOs and senior staff. In fact when asked if there are any auto parts firms headed by women, PAAPAM (where a directory of all auto parts producing firms in Pakistan is maintained) could identify just one firm in Karachi, which falls outside Punjab. In order to explore any possible gender angles in the BER functional areas in the absence of women CEOs, two methods were adopted:

- Male CEOs were asked if they expected there to be any additional problems in each of the topics discussed, had there been a woman handling the case. In none of cases was such a problem expected.
- Two of firms interviewed were specially selected for the high proportion of women employed in their workforce. The CEOs were asked if there are any specific problems related to women, especially labour compliances, maternity leaves etc. The women on the work floor, which included a woman floor manager, were also interviewed. Again, there were no women specific issues reported that fall under BER functional areas.

One interpretation of this could obviously be that there are no gender angles in the BER functional areas for this sector. This is plausible for certain areas such as tax policies and administration and business registration, as these are completed online, and there are no differences in the policies or their administration for women. For other areas, such a private-public dialogue, dispute resolution and interactions with government departments, there may be issues, but these have not surfaced from lack of experience of women actually dealing with any of these issues. There may be rather more fundamental problems that preclude women from heading auto parts firms in Pakistan: opportunity, exposure, education and social acceptance are first order problems that women must resolve first. It is only after that they get to the stage when they have to tackle government related problems. For this reason, it is premature to take a view of gender-specific BER issues.

6.3 Review of Regional/International Best Practices

Looking at best practice amongst regional competitors that have successful auto industries suggests that industrial policy has also been used to create a specific set of investment and tax incentives that have helped incubate the auto industry. This section reviews some of these sector specific strategies undertaken by regional competitors for the auto sector.

6.3.1 China

China has the largest auto industry in the world, producing 24.5 million vehicles every year, which represents 27% of the world's total vehicle production.[35] Historically, China has used a set of subsidies, tariff protection and tax cuts to boost demand for the domestic industry. These included heavy limitations and high tariffs on imported cars and a concerted effort to facilitate joint ventures. The policy followed by China is now

[35] Organisation of motor vehicle manufacturers (OICA) 2016

open market access to foreign automakers in exchange for technology transfer through a 50:50 Sino-Foreign equity joint venture. Foreign owned enterprises that are not in partnership with Chinese firms are allowed only if they will manufacture auto parts or will support research and development for localisation of parts.

Measures that fall within the BER functional areas include a reduction in vehicle purchase tax from 10% to 5% (which was supplemented by subsidies for purchases of cars by rural residents). In addition, environmental protection has been used to eliminate older, more polluting cars by 2017 and incentives have been provided to produce new energy vehicles,[36] where the Government will provide tax exemptions and will invest in charging stations and charging piles to support the move towards the new technology. The industry has been classified as an 'emerging industry' and hence benefits from more subsidies, tax breaks and facilitation.

6.3.2 Thailand

Thailand's auto industry produces 10% of its GDP, provides direct employment for 500,000 people annually and is the one of the largest export industries in Thailand. Thailand has become a regional hub for auto parts manufacturing as a result of concerted industrial policy for the last six decades, which included tariff protection (tariff of up to 150% on imported cars, followed by a complete ban), local content requirements and moratoriums on new assemblers to allow economies of scale for the existing firms. By 1991, Thailand began to liberalise its auto sector, lowering tariffs and lifting the ban on imported cars. The ASEAN Industrial Cooperation Scheme (AICO) and a series of bilateral trade agreements further helped develop export markets.

Thailand's Automotive Industry Master Plans specify a coordinated set of policies to promote investment and domestic market expansion through systematic integration, green technology development and productivity improvements. Examples include a special investment package promoting 'skill, technology, and innovation' (STI), whereby firms were given one or two years of extra tax incentives if they spend a certain proportion of their sales revenue on research and development, and on training employees, and a certain proportion of their workforce comprises of scientists or engineers. One pillar of the Master Plan is to create a good business environment via policy integration. This ensures that government regulations, policies and measures all support the objectives of the automotive industry development and accommodate

[36] These are vehicles that use alternative energy sources, e.g. electric or hybrid vehicles

trends in future competition, technology and innovation. This includes policy research to support the industry and identify obstructive policies.

The Master Plans analyse global trends in the auto sector, e.g. the move towards eco-friendly, fuel efficient and safe vehicles, and set a vision for Thailand's strategic placement within the global market. For this, the Thai Industrial Standards Institute (TISI) and the Department of Land Transport aim to adopt ASEAN MRD standards.[37]

6.3.3 India

India is in the top ten carmakers in the world, producing over three million cars a year.[38] The auto industry has been an important engine for growth in India, and as a whole contributes over 7% to India's GDP. This has been the result of active industrial policy, which includes subsidies, tax breaks and tariff protection. In additional India has its own set of national standards (The Bharat standards), which domestic and imported cars must comply to. This has resulted in minimal imports and the development of a high quality domestic auto sector that can compete in global markets. Auto policy has actively supported foreign direct investment and joint ventures. Trade and investment policies were liberalised in the 1990s once the auto sector had matured, though India still has one of the highest effective protection rates in the region.

The Ministry of Communications & Information Technology provides incentives to auto electronic part manufacturers under which electronics manufacturers in the auto sector who are over ten years old are being reimbursed CVD/excise for capital equipment, a subsidy of 25% is being given on CAPEX, 75% grant for common facilities centres and 75% grant for cost of skilling.

There is also a well-established Regulatory Framework under the Ministry of Shipping, Road Transport and Highways. Specific initiatives that fall within the BER functional areas include credit to farmers to help boost tractor sales. In addition, the cluster development program for auto parts manufacturers: a scheme that provides inexpensive capital to SMEs for technology up-gradation and development. Under the scheme, an Auto Component Technology Development Fund (ATDF) has been set up to provide financing of 50% of the project cost at a concessional interest rate of 4%.

[37] Thailand Automotive Institute (2012) "Master Plan for the Automotive Industry 2012-16"

[38] Afraz et al (2016)

6.3.4 Summary

The discussion above shows clearly that the path to successful auto industries has been through active industrial policy, which has targeted several of the potential impediments. The policies undertaken are comprehensive and include many non-BER interventions, and BER interventions that are not sector-specific but improve the ease of doing business for all types of investors in the economy. Sector specific BER interventions include:

- Tax breaks on investments, technology and land acquisition, and reductions in sales tax on vehicle types which are identified for promotion
- A regulatory framework that specifies and tests national standards, and sets the vision for future technological change, such as environmentally friendly vehicles
- Subsidised credit to upgrade technology and for R&D, which supports firms in making the investments required to meet the vision set for the sector.

6.4 Recommendations

Specific recommendations for the BER functional areas and proposed set of interventions that the Government can undertake are provided below.

6.4.1 Tax policies and administration

The most important impediment identified in the stakeholder consultations relates to tax policies and administration. Issues of uncoordinated and frequently changing polices are under the FBR which is not in the provincial domain. However, the provincial Government can still play an important role.

Provincial Government can lobby for federal taxation policies to ensure that they are synchronised with industrial policy objectives.

A comparison of auto policies in other countries with successful auto sectors shows that the auto policy is a far more comprehensive document than the one followed in Pakistan. The current ADP 2016-21 for example, does not provide incentives for R&D and technology acquisition (e.g. by providing tax breaks for importing machinery), or for market expansion (e.g. by lowering sales tax on small cars). A comprehensive vision for the auto industry must explicitly address all aspects of policy, including direct and indirect taxation. Tax policies taken with the sole objective of maximising short-term revenue collection can be counter-productive to long term industrial development and eventually tax potential.

The Engineering Development Board and the Ministry of Industries and Production, which are both federal, non-auto specific departments, develop the policy for the auto industry. Other countries with successful auto sectors have specific regulatory and research bodies for the auto sector, which are responsible for research and development, establishing standards, providing testing facilities and developing auto policy. In the absence of such specific regulatory bodies, the Department of Industries of the Government of Punjab can play a strong role in developing a provincial industrial policy, which can then be used as a basis to advocate with the federal Government.

6.4.2 Overall quality of regulatory framework

The absence of a specific regulatory agency does not impede businesses directly, but eventually it leads to low quality for the consumer and potentially anti-competitive behaviour in a highly concentrated industry.

Auto standards

It is unusual for a country with a national auto industry to not mandate national quality standards. This should be a priority for federal Government, which the provincial Government can advocate and support in implementation.

The ADP 2016-21 deals the crucial aspect of standards in a superficial manner by suggesting that Pakistan applies for member in Working Party 29 (WP29) of the World Forum for Harmonisation of Vehicle Regulations under the United Nations, without specifying a time frame for membership, or for compliance with the standards. The adoption of nationally mandated standards, whether developed indigenously by the PSQCA, or through WP29 or with the support of other more established auto regulating bodies such as the National Highway Traffic Safety Administration in the USA, is a high priority target for industrial development in the auto sector. Without an appropriate regulatory framework, road safety, consumer protection and environmental protection are all compromised. In addition, it means that the industry equilibrium settles at a low quality, which limits prospects for export. A clear time-line is required, by which well-defined standards have to be met.

Competition

In addition, it is important to undertake a regular and rigorous competition assessment of the auto industry, as it is highly concentrated – whether in the passenger cars, tractors or motorcycles sub-sectors. The OEMs are also in a monopsonistic relationship with the auto parts manufacturers. Both these factors generate market power, which can lead to anti-competitive behaviour. A proper regulatory framework for the auto sector should include regular assessment of competition by the Competition Commission of Pakistan. Again, this is in the mandate of the federal Government, and will require advocacy by the provincial Government.

6.4.3 Quick wins in other areas

Other regulatory departments

For the provincial Government, regulatory agencies such as The Department for Environmental protection could explicitly take measures to support businesses in compliances. The link between regulation and industrial development is missing from government regulatory agencies. Incorporating regulation as part of a larger package of industrial development will ensure that the firms are not stifled with excessive compliances, but that these requirements are counter balanced with positive incentives to encourage and support firms. For example, in several countries the move towards producing environmentally friendly vehicles has been encouraged with a combination of standards which must be maintained, and a set of investment incentives such as tax breaks and research support to encourage the technology acquisition required.

Public-private dialogue

This could be expanded to include better coordination with the auto industry. For example, the auto sector has several associations - for auto parts manufacturers, for vehicle manufacturers, for motorcycle manufacturers and for auto parts traders. The PPD process could include evidence and opinions from all these associations, and also include representation from consumers. A consolidated response from all of the concerned parties to proposed policy changes that is based on analysis and evidence would be a substantial improvement over the current system, which is prone to frequent change on the basis of lobbying by specific pressure groups.

Access to market information

The Industries, Commerce and Investment Department has a remit to facilitate information, and could usefully ensure that firms have access to data that is already collected by various government agencies, such as data on imported auto parts, which is collected by the Customs House.

7. Footwear

7.1 Footwear Overview

The footwear sector in Pakistan, and particularly in Punjab, has shown remarkable growth in the last decade. This growth has been a result of rising exports and increasing domestic demand. However, the export growth has been in low value items that have stagnant global demand (Figure 6.1).

There are currently more than 500 manufacturing units in Pakistan, with almost 60% of them located in Lahore alone.[39] This clustering of footwear manufacturing units around Lahore is not a planned intervention but emerged from within as an endogenous process led by Bata & Servic. The two historic giants of the sector were located close to Lahore, resulting in adequate availability of skilled workforce making Lahore the preferred location for footwear manufacturers.

Pakistan produces over 360 million pairs of shoes a year. The industry is contributing well over US$2 billion to national GDP, or around 1.65%.[40] There are no official statistics available for employment in the footwear sector, however, on the basis of our interviews we tentatively estimate that the sector currently employees around 110,000 to 130,000 workers.[41] The more organised part of the sector has also made progress in export markets. Pakistan exported approximately US$117 million worth of footwear at an average price of US$ 10 per pair, approximately 0.5% of national exports.[42]

Historically, the sector was fragmented. Bata and Servis Industries dominated for decades, controlling over 80% of production. The remainder of the industry was divided between a few medium sized organised production houses and a large number of informal cottage industry. However, over the last decade Bata has gradually exited out of its production business and focused in retail, reducing daily production from around 30,000-35,000 pairs to only 5,000 pairs. This shift in Bata's business model

[39] http://pbit.gop.pl/system/files/retail-sector-report.pdf

[40] Estimated using an average price of PKR 500 per pair

[41] Based on average employment in automated plants of 120 to 200 workers, for smaller units around 50 to 70, and even lower for cottage scale.

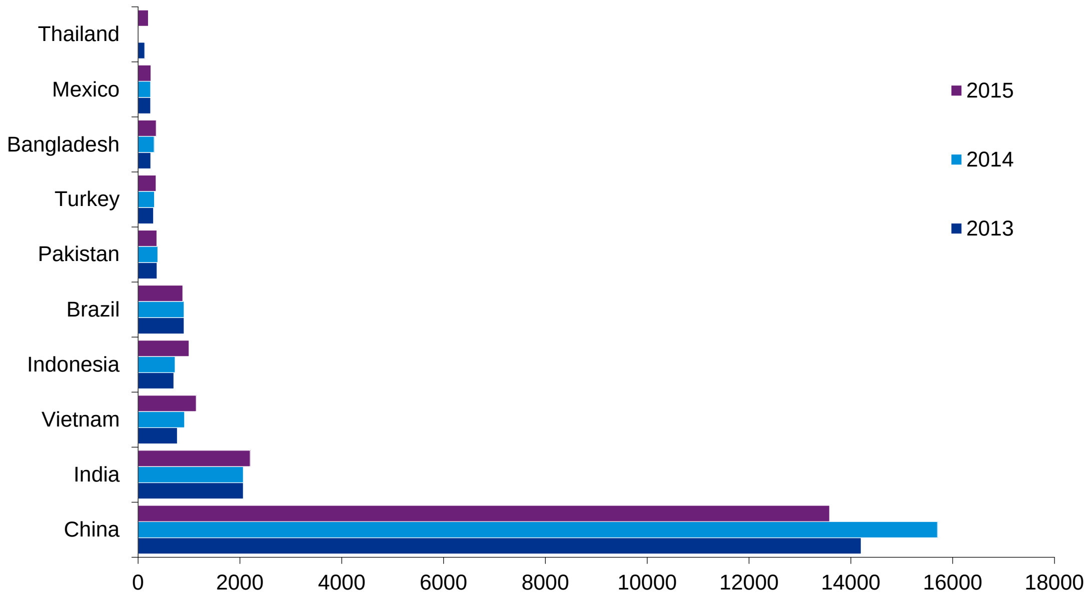
[42] Source: UN Comtrade

has created space for medium sized formal manufactures to enter into the industry and grow.

Almost all major local production houses have established retail chains across the country.[43] Servis alone has over 400 stores in Pakistan, over 2,000 dealers and a growing international footprint in Europe, Middle East, and many other countries. Similarly, Bata has over 370 outlets across the country. The potential of the retail industry has also attracted international brands.[44]

The footwear sector is labour intensive and has a huge potential for domestic as well as export oriented growth. Pakistan is still insignificant in comparison to China, and far behind India and Vietnam in production volumes. Figure 7.2 below provides a production comparison for top 10 manufacturers of footwear in the world.

Figure 7.1: Top Ten Producers of Footwear (millions of pairs), 2013-15



Source: STATISTA

[43] Including, for example, Servis; Ehsan Chappal House (ECS); Stylo; Metro; Starlet; Borjan; and Urbansole.

[44] Including, for example, Hush Puppies, Pierre Cardin, Logo, Charles & Keith, Nike, Aldo and Ecco.

A report by Global Industry Analysis predicts that total world demand for footwear will reach US$ 371.8 billion by 2020. The global population will be around 8 billion and demand 25 billion to 30 billion pairs of shoes per year.[45] Growth projections suggest that Casual footwear is expected to grow the fastest at 6.1% CAGR, followed by Athletic Footwear (5% CAGR); Outdoor/Rugged (4% CAGR) and Dress/Formal.[46] Pakistan is producing low end/low price casual footwear. There is a need for the footwear industry to increase the quality to enter this market segment at a better price point.

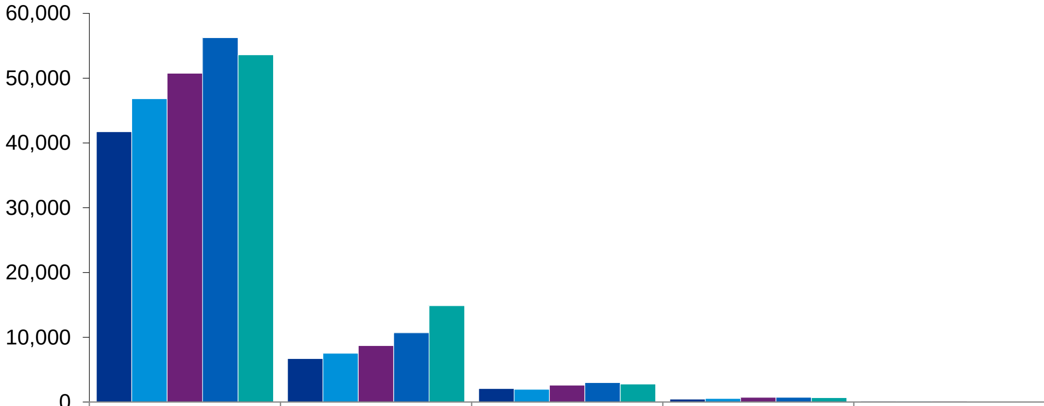
Pakistan has yet to fully exploit the footwear export market. Figure 6.2 below shows that Pakistan exports are far below its competitors and its export mix is mostly in stagnant demand segments For example, one of the key growing segments in the footwear industry is casual shoes (HS Code 6404). Pakistan is a net importer in this HS Code whereas China and Vietnam are the two largest and most rapidly growing suppliers. However, the growing international demand and rising costs of production in China present a large opportunity for Pakistan to gain more access and experience export growth in the sector. Moreover, the population of Pakistan is growing rapidly and, when coupled with factors such as rapid pace of urbanisation, expanding middle class, increasing disposable incomes and greater awareness of fashion and trends, this presents an opportunity for domestic consumer-led growth for the sector. Based on average consumption patterns of footwear the domestic demand can be estimated between 600-800 million pairs a year. Given the domestic market and export potential of the sector, it makes sense for Government of the Punjab to address key business environment constraints to help the sector capitalise on these opportunities and contribute to both the provincial and national economy.

[45] http://www.strategyr.com/pressMCP-2782.asp

[46] http://www.strategyr.com/MarketResearch/Footwear_Market_Trends.asp

Figure 7.2: Footwear Exports (US$ millions) of key countries

Viet Nam 2015 figure estimated



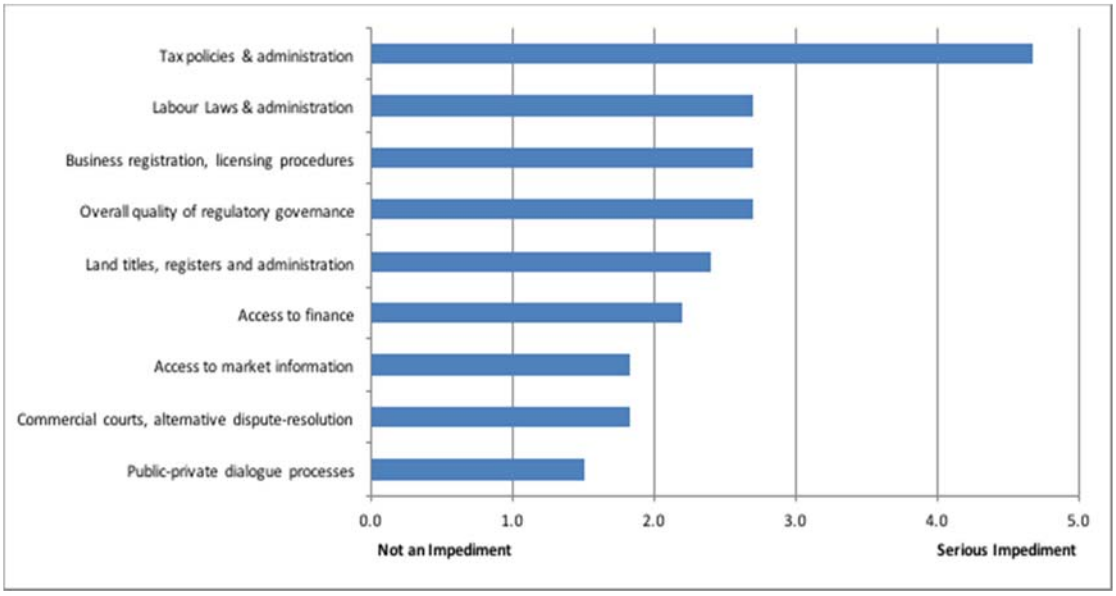
	China	Viet Nam	India	Turkey	Pakistan
2011	41,722.33	6,717.91	2,090.54	441.25	112.26
2012	46,811.27	7,515.32	1,958.29	546.15	102.20
2013	50,761.33	8,721.91	2,609.80	723.22	109.23
2014	56,248.71	10,690.49	2,990.73	719.26	132.22
2015	53,609.48	14,880.00	2,771.02	670.44	116.86

Source: UN Comtrade

7.2 Footwear Diagnostic Section

In assessing the impact of the current business environment on BER functions, the team secured input and feedback from seven footwear manufacturers and the Pakistan Footwear Association. Figure 6.3 below provides a snapshot of how the sector ranks each of the nine BER areas discussed with them during the field work.

Figure 7.3: BER Functions - how severe an impediment is it to business?



The majority of respondents identified tax policies and administration as the biggest BER constraint in the footwear sector. This includes dealing with tax officials, taxation policy and unfair tax notices. Other BER areas noted as most serious constraints were Business Licensing and Registration, Labour Laws and Administration, and Overall Quality of Regulatory Governance.

The next section extends the discussion of Chapter 2, by providing sector-specific details for those constraints that were seen to be particularly problematic for the footwear sector. The common constraints discussed in Chapter 2 that apply equally to the footwear sector are not repeated here.

7.2.1 Business Licensing and registration procedures

Registration & Payment to Agriculture Market Committees

A specific issue faced by the footwear sector is registration with and payment to Agriculture Market Committees. Factories reported that as they were dealing in (processed) leather hides, officials from Agriculture Market Committees turn up requiring them to pay market committee fees that are due to leather trading. This is an unnecessary requirement as the footwear industry uses processed leather as an input rather than to trade in it.

Ineffective Protection of Property Rights (Policy & legal, Institutional)

The footwear industry globally thrives by developing new designs and brands, and protect their competitive advantage through patents and copyright. Intellectual property protection in Pakistan is weak, and firms do not trust the Intellectual Property Organisation's enforcement capacity. Although efforts have been made in recent years to digitise intellectual property records, applications still take a significant amount of time.[47] Moreover, the enforcement and protection of intellectual property rights are still weak. An example of this is Servis, one of the largest footwear manufacturers which has a well-established brand by the name 'Cheetah'. However, the same name is apparently being used by another company, 'Xarasoft', and there is no support available for Servis to take action against it. This is not only affecting the local footwear sector but is also a big deterrent to foreign brands coming to work in Pakistan.

7.2.2 Tax policies and administration

Increased Cost of Production due to Ad Hoc Tax Administration

The exporting footwear sector operates on just-in-time delivery schedules and work with extremely sensitive buyers. The companies are already struggling to make a reputation with these international buyers. Unfair and ad hoc notices by FBR stall the business process, especially if notices result in bank accounts being sealed. Most of the time such delays are managed by sending the entire shipment via air cargo instead of sea, adding US$1 - US$2 per pair of shoe. Given the average selling price is around $10 this is a big additional cost.

Unfriendly Import Duties (Policy)

Certain inputs that are not made in Pakistan but are required by the footwear sector are heavily taxed. An example of this is 'foiled leather', a plastic sheet that is pasted on leather to give different fashion looks and glossy finishes to shoes. There is no manufacturer of foiled leather in Pakistan, yet it incurs an import duty of 25%, making it more cost effective to get the shoes made in Spain than locally. Similarly, certain machines used in the footwear sector attract a 5% duty, however, if a replacement part of the same machine is imported it attracts a duty of 25%. This simply adds to the cost.

Duty Draw Back Policy (Policy and Administrative)

The leather industry has, in the past, used the Duty Drawback (DTRE) scheme on imported chemicals for export production. However, the range of chemicals used has increased and their nomenclature has also changed. As customs lists are not regularly updated, most of the chemicals currently used no longer qualify for DTRE. Footwear

[47] In particular through the EU Funded Trade Related Technical Assistance Programme.

businesses are forced to use export rebates rather than the initially useful DTRE scheme.

An SME interviewed has a joint venture with Caterpillar, an international brand. The royalty payments have been approved by FBR for taxation purpose. However, the company still keeps getting notices and have to incur informal costs to resolve the issue. The same company also reported that it costs 5-6% of revenues to comply with tax policies and tax payments.

7.2.3 Access to finance

Most of the footwear sector, especially new entrants, rely on equity as opposed to formal credit. Credit products currently in the market do not suit the needs of the sector. The footwear process in Pakistan involves a large amount of unfinished and finished goods in stock, so requires a large amount of 'tied-in' capital. Banks are not willing to consider this tied-in capital as collateral, despite it being straightforward to keep count, ensure non-perishability and estimate the broad market value.

7.2.4 Labour laws and administration

The exporting segment of the footwear industry is subject to audits and must also comply with all labour laws.[48] This creates two specific problems. First, the firms that are not exporting do not meet these requirements and hence have a cost advantage when supplying in the local market. Second, the vagueness in labour laws adds an extra financial burden on companies to ensure compliance for their buyer needs. The lack of capacity of labour inspectors to advise on appropriate measures forces factories to hire additional consultants and experts to help them to improve their worker environment and compliances, so that the auditors appointed by the buyers will give a 'clean sheet' to the factories.

[48] These include, for example, WRAP, BSCI, SADEX and TOE Audit of LEVI's.

The Deputy Director of Pakistan Employees Social Security Institute (PESSI), Gujrat initiated three cases against an SME. In the first case the amount recoverable by PESSI was PKR 4.80 million, covering the period from January 1987 to September 1992, on account of short payment of contributions. In the second case, PKR 1.98 million was to be recoverable by the Company from PESSI on account of wrongly paid contributions covering the period from July 1992 to September 1993. Both cases were decided against the Company by the Director General Recovery PESSI, Lahore without paying any attention to documents and counter proofs provided. In the third case, Rs. 77.6 million is to be recovered by PESSI. This case was decided in the favour of the Company in the year 2013 but the case was re-opened in 2014. The Company filed an appeal before Social Security Court, Lahore, however, even during the pendency of the matter PESSI sent a recovery notice. The Company has now filed a writ petition before Lahore High Court and the case is still under discussion.

7.2.5 Overall quality of regulatory governance

There is currently no institution responsible for certifying quality standards and compliances for the footwear sector. The manufacturers selling in the local market are able to sell shoes of any quality and material without even fully declaring its characteristics. Exporting firms rely on expensive international certifications. This lack of a recognised standards body in the country creates an issue for both local market firms and exporters.

For manufacturers supplying the local market there is no incentive to invest in improving quality, encouraging a race to the bottom. Those firms which do try to improve quality struggle to compete and fail to graduate on the value curve and to think about exporting.

The firms that are already exporting face serious difficulties, delays and huge costs in obtaining certifications. As no advice is available locally, they have to procure international services, which are not only expensive but have a long tag time due to visa issues and consultants unwilling to fly to Pakistan due to adverse travel advisory.

7.2.6 Alternate Dispute Resolution Mechanism

The Pakistan Footwear Manufacturing Association (PFMA) is the only platform that is available to resolve disputes that arise within the sector, but membership is low, and the Association has no power to ensure compliance on decisions taken.

7.2.7 Public-private dialogue processes

The sector states that there is no legal or formal channel to communicate with the government on specific issues affecting the sector, and relies upon personal relations and networks with the policy makers. The PFMA is usually invited to all discussion forums but these are seen as redundant and ineffective. The PFMA is active in taking issues faced by the sector to the different government counterparts, however, action rarely follows.

7.2.8 Access to market information

There is limited access to market information. The PFMA has no formal capacity to undertake research and receives no support from Chamber's research department to develop relevant market information. They have no staff that can work to developing such information, neither such an access point exists within the government. Acquisition of information by new entrants becomes even harder as they are not networked within the sector, and as a result, it has failed to benefit from the Pakistan's GSP Plus status due to lack of information.

Businesses interviewed had positive opinions about the Pakistan Institute of Fashion Design which is conducting a special course on footwear, and producing well trained graduates that are of great support to the industry. Similarly, an EU Funded Programme, Pakistan Leather Initiative, invited an Italian expert to provide information of upcoming fashions, trends and products that was useful for the businesses as they explored new opportunities.

Gender Specific BER Issues for Footwear

The manufacturing industry is dominated by male CEOs, and none of the businesses interviewed had a female CEO. Some of the companies were employing female workforce, especially in the design and marketing departments. Female graduates from the Pakistan Institute of Fashion Design (PIFD) are coming into the footwear industry and some of the firms reported that they were far superior to their male counterparts. The female students coming from PIFD are confident, possess good people skills, and are excellent designers who have potential to be strong entrepreneurs. This is encouraging from a gender perspective as a more balanced trained workforce is being attracted by the sector.

Dealing with government officials may be more cumbersome for females than for men. Dealing with sales tax notices or getting file clearance from LDA is clearly seen as a man's job simply due to the hostile attitude of these offices and the time one needs to spend in moving from one desk to the other.

Similarly, businesses reported that female CEOs, especially of SMEs struggle more in acquiring business information and making themselves heard. As there is no central place to acquire information and female CEOs are not part of the usual sector business networks, they have little access to information. As an example, the Lahore Chapter of Entrepreneur Organisation (EO) has less than 5% female CEO membership. EO is an international platform that offers business leaders to form networks and benefit from cross sector information and develop linkages. Finally, in terms of PPD, women are usually less represented, especially from the footwear association point of view there has never been an active participation of females in policy dialogue.

7.3 Review of Regional/International Best Practices

As discussed at the start of the chapter the leading countries in footwear include China, Vietnam, India and Italy. In order to learn lessons from their success this section provides a regulatory and policy environment comparison among the countries.

7.3.1 China

The growth of leather and footwear industry in China is attributed to a first phase of economic reforms in 1978, with rapid development of town and village owned enterprises and the second phase of foreign firms investing in China. Government provided large incentives in forms of subsidised land, reduction of import duties and tax holidays. In the 1990s, the Government made further reforms that included reforms of the tax system and other measures to ease the cost of doing business. During the recent global slowdown, the government implemented a four trillion yuan investment package to ease access to finance and stimulated demand for 10 industries including footwear.[49]

Specific tax incentives that have been available to the industry have included:

- Two years' tax exemption from the date enterprises first make a profit and a 50% reduction to tax for the next 3 years.
- Lower taxes in the Export Processing Zones (corporate tax at 15% instead of 55% for domestic firms and 40% for FIEs).
- Additional 10% tax exemption for firms which export more than 70% of produce.
- Export tax refund of 15-17% for leather products with a clear, transparent and efficient refund system.
- Imports of raw material, chemicals and machinery for footwear was allowed at near zero rates.

In addition to tax incentives, the Government has also subsidised land, research and development, electricity and other utilities. Local authorities have had delegated power to approve foreign investment and a one-stop shop for expedited approvals established.

To enforce quality and standards, China developed and registered an internationally recognised trademark, 'Genuine Leather Mark'. Local governments provided direct services for establishing brands for industrial clusters and building industrial parks.

[49] *Leather & Footwear Report, Ministry of Science & Technology, Government of India,* http://www.dsir.gov.in/reports/isr1/Leather%20and%20Footwear/3_17.pdf

All of these industry driven policies in China have been matched with significant investments in transport infrastructure, telecommunications, and power and utilities. Much of the effort has focused on specific geographical areas earmarked for the leather, and this clustering has led to closer PPD and the quicker resolve of issues around taxation, labour, land, environment compliance, and policy support.

7.3.2 Vietnam

Vietnam is one of the largest footwear producers in the world. The economic and industrial growth in Vietnam was initiated as result of the Doi Moi reforms of 1986, including support for international joint ventures. In just 10 years Vietnam was able to attract over 300 joint ventures and foreign owned enterprises in the footwear sector. A key feature of the development was the Vietnam's Leather and Footwear Master Plan which had the following key features:

- Investment promotion, with priority being given to the development of raw materials and accessories for the industry.
- Direct investment in leather manufacturing plants and leather tanneries in order to improve the quality of leather made for footwear manufacturers, as well as training in professional knowledge and skills and international laws. Priority was given to training shoe designers and proficient marketing and import-export staff for businesses. [50]
- Low cost land and tax incentives were given to encourage joint ventures in the production of leatherette raw materials and accessories, shoes, slippers, handbags and suitcases, which gradually reduced imports.
- Manufacturers were relocated to ease labour pressures.
- Footwear industrial parks were built, encompassing good infrastructure conditions and environmental treatment facilities, in a bid to draw and facilitate investment in the footwear industry.

7.3.3 Italy

Whereas as China and Vietnam cater to volume market segment in footwear Italy has specialised its SME footwear and leather sector to cater for high value added and high

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[50] *Leather & Footwear Report, Ministry of Science & Technology, Government of India, http://www.dsir.gov.in/reports/isr1/Leather%20and%20Footwear/3_17.pdf*

end fashion products. However, similar to China and Vietnam, Italy has also focused on clustering the SMEs in leather and footwear in four main areas of Lombardy, Toscana, Venice and Campagna. The main driver behind the SME growth and specialisation in Italy has been the implementation of the Sabatini Law 1965 and SME Innovation Law 1991. The Sabatini law focused on the issue of access to finance. Under the provisions of the law it was made simple for Italian SME's to have access to finance for capital that they kept investing in high technology and research to keep upgrading the quality of their products. The law allowed the acquisition of machine tools by SMEs by subsidising interest rates, and allowing the buyer to pay in instalments. Around US$23 billion (taking current exchange rates) of investment took place under the Sabatini Law.

The law on SME Innovation seeks to promote development, innovation and competitiveness of small firms. It not only intervenes by supporting firm investment, but also by creating the conditions necessary for competitive growth. These include measures that ease up doing business in Italy, which is evident from a score of 44 on World Bank ease of doing business. The innovation law also puts emphasis on the active participation of local institutions in consortia in roles of responsibility and being the vehicles of economic development.[51] More specifically the law allows special dispensations on a case by case basis to SMEs in their needs to access credit, acquire specific technology, acquire information, get approvals for required registrations and help them brand as Italian products.

7.3.4 India

India, learning from the Vietnam and China experience realised it was being left behind in the footwear sector. In order to facilitate the businesses, India initiated the liberalisation drive and most of the items manufactured in the leather sector were de-licensed. Furthermore, like Pakistan, 100% Foreign Direct Investment and Joint Ventures were permitted through the automatic route with 100% repatriation of profit and dividends.

Secondly, Foreign Trade Policy (2004-2009) provided several incentives to exporters to boost the export prospects of the industry. It resulted in procedural simplification and trade facilitation measures. Measures such as the Focus Product Scheme (FPS) and the Duty Entitlement Passbook Scheme (DEPB) were extended in the Foreign Trade

[51] *Leather & Footwear Report, Ministry of Science & Technology, Government of India,* *http://www.dsir.gov.in/reports/isr1/Leather%20and%20Footwear/3_17.pdf*

Policy (2009-14). Various other benefits available to exporters of leather products include: duty neutralisation/remission schemes in place like Duty Drawback; duty free import of certain raw materials, such as raw and finished leather, fur skins and high value items; concessional duty on imports of specified machinery for use in the leather sector; and a low import tariff, with a peak rate of 10%.

Similar to Pakistan, much of the growth in the leather and footwear sector in prominent traditional hubs of Agra, Kanpur, Jalandhar, Ambur-Ranipet-Vaniyambadi and Kolkata was unplanned, and was almost entirely due to private sector initiative. The Government is now making significant investments to improve the existing infrastructure in various leather clusters by developing integrated supply chain infrastructure (material markets, tanneries), production infrastructure (water supply, drainage facilities, power supply, effluent treatment plants, and factories for ancillary products) and support facilities (design and product development studios, testing laboratories, training institutes, and buyer-interaction showrooms).[52]

7.3.5 Summary

Based on the comparison above the lessons one can draw from countries currently leading the leather and footwear circuit globally include:

Firstly, an unorganised industry structure lowers competitiveness. The returns to organising the footwear sector and clustering them through organised industrial zones have worked for key competitor countries. The main advantage in organising the industry at a common location is that their concerns and issues are addressed as a group. One window business facilitation, tax breaks and other support and initiatives can be provided without distorting local competition. The country analysis provided above also reflects that it becomes easier to design and implement industrial policy interventions if the industry is more organised.

Secondly, foreign investments have played a major role in developing footwear in China and Vietnam. The business environment must therefore be made conducive to FDI. Joint ventures with international brands help in improving quality and product variety of local industries. Carefully designed trade agreements can support industry

[52] *Leather & Footwear Report, Ministry of Science & Technology, Government of India,* *http://www.dsir.gov.in/reports/isr1/Leather%20and%20Footwear/3_17.pdf*

in securing export shares in major markets. Vietnam, for example, was able to increase exports to the USA and Europe through trade agreements.

Thirdly, several of the countries above have a devolved government structure. In Pakistan, the local government's role in terms of facilitating the industry is minimal. Apart from few building licences or fees they have no role to support the industry. The examples above suggest that key competitor countries have allowed a greater autonomy to local government, and that they are able to provide low cost land, business registration facilitation and operational support directly to the industry.

Finally, all competitor countries are investing heavily to improve the environmental compliance capacity of its industries. The modern industrial zones (see box below) come equipped with the latest clean technologies and waste disposal systems. Moreover, countries are providing subsidies and support for industries to upgrade their production technologies and move towards producing a cleaner environment. Linked to this is the establishment of brands that not only represent quality but are recognised as environmentally friendly.

7.4 Recommendations

7.4.1 Quick wins – Footwear specific

Tax Policy & Administration

The footwear sector in Pakistan, as in Vietnam, Bangladesh and India, is reliant on key inputs imported from different countries. The most common products imported include fashion accessories, value adding materials and decorative parts. None of these products are being manufactured in Pakistan at the moment, yet attract high rates of duty. The provincial government should, in the short run, advocate with customs to allow duty free import of such products. In the medium term it should give incentives to attract investors and industrialists to establish this ancillary industry in the province. More specifically, as a priority, PBIT should advocate with federal government to allow duty free import of material such as 'foiled leather' and other such value adding materials that are not currently produced in the country. Moreover, PBIT should develop a list of key machinery used by the footwear sector and advocate with federal government to allow parts of such machines to be imported by 'manufacturers' in 'small' quantities at the same duty rate that is applicable on the machine. Currently, if a part goes faulty the manufacturer pays a duty as high as 25% as compared to a duty rate of 5% on the machine.

Key regional competitors of Pakistan such as India and Bangladesh use Duty Drawback (DTRE) schemes to refund duties paid on inputs that manufacture products for export. A detailed and carefully designed DTRE scheme can help the manufacturers keep their costs low, especially for a sector such as footwear which requires a lot of imported inputs. However, for a DTRE scheme to be effective the customs officials responsible have to keep updating the inputs that are being imported so that an accurate estimate of duty percentage on inputs is established. In Pakistan this has not happened, and the items on the DTRE list do not reflect all the inputs currently used by the sector. It is recommended that DTRE Scheme should be revamped for the leather and footwear sector, and inputs must be correctly accounted for to establish an accurate percentage for duty drawback. The Industries Department, GoPB, should work with PFMA to develop this list and duty rates, and advocate with the federal government.

7.4.2 Medium to Long Term – Provincial Government interventions – sector specific

Business Registration & Licences, Land Registration & Regulatory Governance

The analysis reveals that most of the business environment issues faced by the footwear sector results from a disorganised and scattered industry. Almost all the areas excluding federal taxation and access to finance can be addressed by the provincial government. International evidence shows that these issues have been easily addressed by organising industries into clusters. The Government of Punjab should establish a footwear industrial park that offers strong incentives for industry to relocate. The industrial park should address the following BER issues:

- Provide low cost land with clear titles and developed to a stage where it is suitable for construction of heavy industry. Currently there are around 300 factories in Lahore, and to allow for reasonable growth one can assume that land allocated should be sufficient for 500 units to allow new companies, especially foreign owned enterprises, to invest in the sector.
- Provide a one window operation for all provincial government registrations, taxation, monitoring and compliance. The work force for each unit must be registered with the park authority, who will be made responsible for managing EOBI, social security and other worker benefits.
- Environmental compliance should be filed with the park authority who would deal with the Environmental Protection Agency. The development of the park should preclude further environmental and building safety issues.
- Provide further subsidy on land cost where companies bring in joint venture partners.

- Courses relating to international trade laws and local laws affecting manufacturing may be included at Pakistan Institute of Fashion Design so that when the footwear graduates are employed at the park they also assist businesses in meeting legal and policy requirements.
- The Park Authority should include representation from industry and should serve as a proponent of key policy measures that will accelerate the growth of the sector in the Punjab.

7.4.3 Provincial Government to Advocate with Federal Government

The lack of quality standards and compliance in the sector hurts the industry in local as well as export markets. In local markets, good quality manufacturers are unable to compete with low quality producers and in export markets Pakistani footwear is unable to register a quality mark. PICRA and the Industries Department should work with PSQCA to establish a Punjab specific footwear quality mark, similar to other countries, and invest in international accreditation.

Essential Features of Successful Industrial Parks

National development strategy

Industrial parks can only contribute to industrial development in the context of an overall development strategy. Without macro-economic policies ensuring a favourable business climate, and without an adequate power and transport infrastructure, investment in an estate may not work. Most successful examples have used one window facilitations and specific policy options to address this.

Clusters

More modern industrial parks are sector specific and hence work towards creation of clusters. This approach helps the companies to operate with higher efficiency, drawing on more specialised assets and suppliers with shorter reaction times than when working alone. Clusters usually collaborate with research institutes, technology labs, productivity centres, venture capitalists and other providers of business development services.

Location

Unless the location is well chosen, an industrial park will fail to attract many firms. The size of the plots of an industrial park/zone and its cost must also be in accordance with business and market needs and expectations. More specifically, industrial parks need to be easily accessible (proximity to a port or an airport, and road/railway transportation to the infrastructure and the nearest urban centre). There also should be a large supply of human resources available at a reasonable cost, and quality of life and personal/cultural services should be taken into consideration.

Infrastructure and service provision

In addition to basic infrastructure and services, successful parks also offer various inputs such as including turn-key electricity, telephone, internet, water, sewage treatment, transportation, and residence. Some also provide accommodation to host SMEs and start-up companies.

Management capacity

The success of industrial parks depends on efficient and responsive management. A park's managing company must provide guidance and support so that business planning is conducted smoothly. This includes marketing, information, procedural support, and trouble-shooting; quick and effective responses to customer demands are key. Initiatives to cut waste, pollution, and traffic congestion are likely to be at the top of the agenda for those involved in managing more sustainable industrial areas.

Innovation linkages

Support institutions should be established that help firms meet the information, skill, finance and other needs that are difficult to satisfy in open markets.

Marketing and promotion

Park managers must promote and market the industrial park and its specialised services at national and international events that suits the needs of the tenants.

Networking

Industrial parks should develop links with similar organisations existing in local and regional areas. Networking increases the spectrum of collaboration (sharing of equipment, transport facilities, security, etc.), increases visibility for investors, increases the quality of services that industrial parks can provide for tenants, and facilitates the exchange of knowledge and best practice, either in the development of industrial parks or in their management.

- Source:https://www.unido.org/fileadmin/user_upload/Europe_and_Central_Asia_Regional_Conference_on_Industrial_Parks_as_a_tool_to_foster_local_industrial_development.pdf

8. Agriculture

8.1 Agriculture Overview

During 2014-15, agriculture contributed 20.9% to the national GDP and is a source of livelihood for 43.5% of rural population.[53] The sector grew by 2.9%, driven by growth registered across all key agriculture sub-sectors. Agriculture is the mainstay of Punjab's economy and has 57% of the total cultivated and 69% of the total cropped area of Pakistan.[54] The sector covers a variety of crops and activities, however, the focus of the analysis presented here is on development of two key agriculture sub-sectors, horticulture and agro-processing.

8.1.1 Horticulture Overview

Horticulture is an important sub-sector of agriculture and generates 12% of agricultural GDP. This sub-sector produces a broad range of vegetables, fruits and flowers, with citrus and mangoes the main crops, grown in diverse geographic and climatic zones across the country. Horticulture has grown steadily to become the largest category in agricultural trade.

A total of 15 million tons of fruits (6.9 million tons) and vegetables (8.1 million tons) are grown annually in Pakistan. Pakistan's horticulture industry operates across various climate zones which enables the country to produce a wide range of fruits and vegetables. In fresh fruit, Pakistan is a premium producer of mango, kinnow, apples, dates, grapes, peaches, melons, and apricots.

The nation cultivates Kinnow on 200,000 hectares of which 194,500 hectors are located in Punjab, where Sargodha (the 'Kinnow capital of Pakistan') is located. The Punjab government estimates that over 90% of global production of Kinnow comes from Pakistan.[55] Pakistan also ranks as the world's fifth largest producer of mango and dates and the second largest producer of mango in South Asia. Due to better export prospects, the cultivated area of mangoes has increased over the last few years from 172,384 hectares in 2011-12 to about 175,142 hectares in 2013-14. [56]

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[53] Economic Survey of Pakistan

[54] http://www.agripunjab.gov.pk/

[55] http://www.brecorder.com/br-research/999:all/6438:stpf-2015-18-and-horticulture-sector/?date=2016-04-07

[56] Ibid.

The majority of Pakistan's production of fruits and vegetables are sold and consumed in the domestic market. Demand for horticulture produce has been on the rise over the last two decades, owing to population growth and increasing income levels.

Horticulture has immense potential to contribute significantly to exports as the country already enjoys global demand for its fruits, especially kinnow and mangoes. Over the years, Pakistan has captured multiple markets for its fruits and vegetables in the Middle East, European Union, Southeast Asia, United Kingdom and other Asian markets. Pakistan earned US$650 million from exports of horticulture production in 2015, whereas worldwide horticulture trade was US$157 billion.[57] Therefore, income from and exports of horticulture products can be increased significantly by further developing the country's horticulture sub-sector.

8.1.2 Agro-processing Overview

Agro-processing refers to the subset of manufacturing that processes raw materials and intermediate products derived from the agricultural sector. In Pakistan, the agro-processing industry is dominated by traditional food (wheat, rice) and industrial crops (cotton, sugar cane).

Rice

Rice is an important food and cash crop in Pakistan, and it is the second staple food after wheat. Pakistan is the eleventh largest producer and fifth largest exporter of rice. In Pakistan's agrarian economy, rice plays many important roles. For instance, it adds over two million tonnes towards the national food requirement, it is an important source of employment and income for the rural populations, and it contributes to the country's foreign exchange earnings with almost US$2 billion in 2015.[58] Moreover, it accounts for 3.2% in the value added in agriculture and adds 0.7% to the national GDP.

In Punjab, rice is cultivated in Sialkot, Wazirabad, Gujranwala, Sheikhupura, district Gujrat, Sargodha, Faisalabad and Kasur[59]. Among the most famous varieties grown

[57] Source: UN Comtrade, using HS codes 07 (Edible vegetables and certain roots and tubers) and 08 (Edible fruit and nuts; peel of citrus fruit or melons).

[58] Source: UN Comtrade.

[59] http://www.foodjournal.pk/Sept-Oct-2013/Sept-Oct-2013-PDF/Exclusive-article-Rice.pdf

in Pakistan include the Basmati, known for its flavour and quality. Rice production comprises 40% of Basmati type and 60% of coarse types. Basmati rice is mostly cultivated in Punjab with non-basmati varieties grown in Sindh.

More recently the slow-moving demand and falling prices of rice have resulted in a significant rise in unsold stock across this industry. Exports of basmati rice in particular have come under pressure due to competition from India where lower cost of production and higher quality of output has led to a boost in Indian rice exports.[60]

Sugar

Pakistan belongs to the 10 largest sugar producing nations in the world. Over the years, domestic sugar consumption has grown from 0.5 million metric tons in 1975 to 4.7 million metric tons in 2015. Per capita consumption of refined sugar in Pakistan is estimated at 25 kg in 2015, notably higher than other Asian countries such as India and Bangladesh.[61] This rise in demand is linked to the growth in processed food sectors (such as sweets, ice cream and soft drink) which account for almost 60% of the total domestic sugar consumption.

The sugar industry employs over 1.5 million people as direct or indirect labour and sugarcane industry contributes to 0.7% of GDP. Out of 84 sugar mills in Pakistan, 44 mills are located in Punjab, 33 mills in Sindh and remaining mills are located in Khyber Pakhtunkhwa.[62] Currently, sugar production in the country stands at 5.1 million tonnes.[63]

Edible Oil

In 2015, Pakistan imported almost $2 billion worth of edible oils.[64] This imported edible oil meets over 70% of the country's total annual edible oil consumption of 3.7 million tons. Imported edible oil primarily consists of palm oil from Malaysia and Indonesia.

At present, Pakistan has 120 licensed manufacturers of edible oil that have an annual production capacity of 3.6 million tons. The country has two main sources of edible

[60] http://www.jcrvis.com.pk/docs/Rice201601.pdf

[61] http://www.jcrvis.com.pk/docs/Sugar201510.pdf

[62] http://www.jcrvis.com.pk/docs/Sugar201510.pdf

[63] http://www.pacra.com.pk/uploads/doc_report/SugarSector_Mar16.pdf.

[64] Source: UN Comtrade

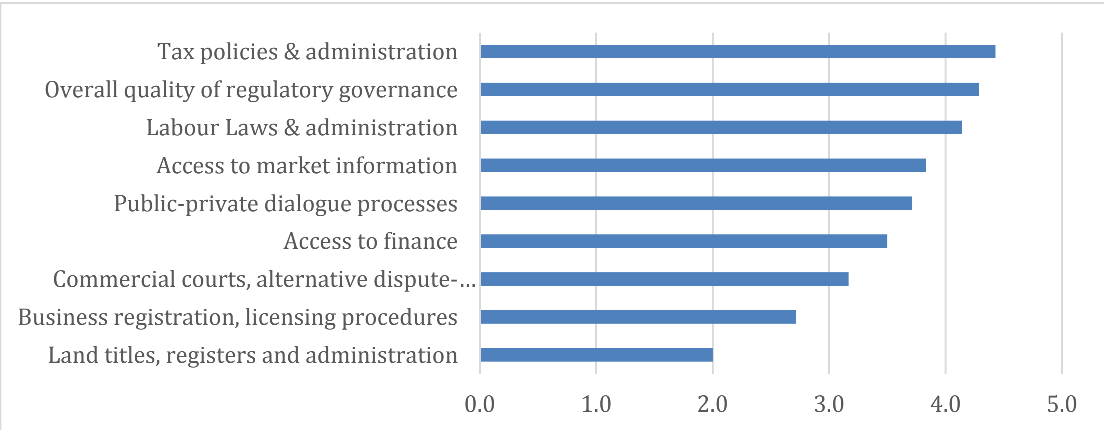
oils: cottonseed (which is a by-product of the cotton ginning industry) and rapeseed or mustard seed (which is traditionally grown on rained marginal land).

All efforts made so far to enhance local production of edible oil have been unsuccessful and the gap between production and consumption continues to widen.

8.2 Agriculture Diagnostic Section

In assessing the impact of the current business environment on BER functions, the team secured input and feedback from eight horticulture and agro-processing businesses. These included four horticulture trading and processing businesses and four agro-processing businesses. These firms were also asked to rank the BER functions in order of the severity with which they impede businesses. The rankings of BER function by agriculture firms is provided in Figure 7.1 (below). Tax policies and administration, overall quality of regulatory governance and labour laws and administration were identified as the most serious impediment to business reported by firms.

Figure 8.1: Agriculture BER rankings



Source: Interview data

Provided next is a discussion of sector specific issues faced by horticulture and agro-processing businesses. This section extends the discussion of Chapter 2, by providing sector-specific details for those constraints that were seen to be particularly problematic for the agriculture sector. The common constraints discussed in Chapter 2 that apply equally to the agriculture sector are not repeated here.

8.2.1 Business registration and licensing procedures

Market Committees & Registration (Regulatory & Administrative)

Horticulture SME businesses, or commission agents, are on the front-end of the horticulture value chain. They source commodities from farmers and supply these onwards to the processing entities or to the markets. This trading occurs at the fruits and vegetables markets and is overseen by Market Committees. Businesses across the board were dissatisfied with the performance of these committees and raised serious concerns about their ability to deliver management and oversight support.[65] They also noted that the induction criteria for membership was out-dated (for example, the requirement for the Chairman to have completed Matric, or, tenth grade) and that most inductions are not merit based but done out of political patronage.

Regulatory Burden on SMEs (Legal & Policy)

The large agro-processors did not consider registration requirements as an issue, and did not require any approval from the Government in order to bring new products to the market. The SME agro-processors had a different experience, and noted that problems start soon after registration. They have deal with up to 25 agencies, all of whom ask for unofficial payments. Businesses routinely (monthly) pay off a number of agencies, such as social security, EOBI, welfare tax and market committees.

8.2.2 Tax Policies and Administration

Tax Liability (Regulatory & Administrative)

Horticulture SME businesses said that FBR determined their tax liability based upon the turnover in their bank accounts, but did not factor in the money that was paid out to the farmers. This resulted in an overestimated tax liability calculated by FBR.

SMEs which supply commodities to larger horticulture processors said that tax compliance was not an issue as their taxes (4.5% withholding tax and 17% sales tax) were withheld during the transaction.

[65] When formed initially in 1939, the purpose of these committees was to safeguard interests of growers and protect them from exploitation. However, under the Punjab Agricultural Produce Markets (General) Rules 1979 these committees were given much broader authority and now influence how the market works. Among other powers, these committees directly impact agribusiness as they are responsible for rates of commissions, fees and charges within the market and for issuing licenses to agro-based industries, commission agents and market functionaries.

According to one SME, their company employs 140 employees in their head office, of which 60 are accountants that are charged with dealing with day-to-day tax and finance issues and concerns.

8.2.3 Access to Finance

Bank Transaction Costs (Legal & Policy)

Horticulture SME businesses said that previously they would collect funds (from their trades) and deposit these in the farmer's bank accounts. However, since a 3% transaction charge was imposed two years ago, bank usage by these commissioning agents has plummeted by approximately 90%. This is mainly because if they were to use the banks then their transactions would be charged twice – once for putting money into the farmer's accounts and then again when the farmer would take the money out of their account. The business informed that normally farmers took their payment in cash so that they do not have to pay this additional charge. Some banks now offer a nominal flat rate charge of PKR 300 if the funds are deposited directly in the farmer's account, which works out to be a cheaper and better option for the farmers.

Some agro-processing businesses noted that securing financing was a risky proposition in their industry as prices of their input commodities tended to fluctuate which made it difficult for them to lock into loans.

A rice processing SME reported that bank financing is not generally available for their sector. They have to invest substantial amount of capital in purchasing rice and storing it for later use. They did not opt for bank financing as the price of rice fluctuates, which can result in losses, and they have witnessed many rice processors forced into bankruptcy because of this. As such, they prefer to avoid bank loans.

8.2.4 Labour Laws and Administration

Reliance on Day Labourers (Regulatory & Administrative)

Horticulture SME businesses interviewed did not have labour law-related issues as they usually hire a contractor who in turn hires and manages a team of temporary day labourers. They have very few permanent staff (mostly, accountants and recovery staff), most of whom are not registered with the labour department. Large processors usually hire a contractor who in-turn sources and manages teams of daily or weekly labourers. In this way they do not have to register these workers, avoiding confrontations with labour inspectors.

8.2.5 Quality of Governance

Commodity Pricing (Regulatory & Administrative)

Horticulture sector SMEs had limited contact with public sector entities (including the Department of Agriculture), and they only dealt with the market committees managing the fruit and vegetable markets they operated in. They were not satisfied with the level of support provided by the Market Committees. The committee issues a daily price list for commodities which are calculated by taking a simple average of different grades/qualities of a given commodity, and do not reflect actual market pricing.

Generally, agro-processing businesses noted that the Government was more focused on supporting farmers and was not equipped to support their industry.

Businesses interviewed noted that securing government approval sometimes became an issue if they wanted to access and utilise new high yield inputs. Other issues reported by these businesses are:

Role of Brokers (Institutional setup)

Businesses said that the role of brokers (middlemen) needs to be effectively managed. These market agents usually take a commission (0.25% to 1.5%) per transaction and, sometimes, manipulate supply and demand (stocking commodities) to affect commodity market prices.

Role of Market Committees (Institutional setup)

The role of market committees needs to be strengthened and better monitored. Businesses said that these committees take a "fee" and do not add much value. Businesses reported being hassled by these committees if they did not make the monthly payments.

8.2.6 Public Private Dialogue

Horticulture SME businesses are not involved in or consulted during the policy making process. Larger businesses noted that they are consulted by various government agencies and they use these opportunities to discuss issues and concerns faced by them/their industry.

Agro-processing businesses want a public private dialogue platform that promotes a culture of evidence based policy making, and which is an effective combination of academic institutions and public and private sector stakeholders. These businesses said that they had regular interaction with the Agriculture Department, however, the Department lacks the resources and capacity to provide the necessary support (e.g., undertake critical research). They also added that LCCI and other industry associations were useful in resolving industry-wide concerns.

8.2.7 Access to Market Information

Horticulture SMEs said that there was a need for a portal that can provide real time information for produce. Currently, they did not have an accurate source for market information.

Larger horticulture processing businesses also noted that their industry would benefit by having access to real time information on markets rates, and pricing as well as retail pricing from different competitors. They also suggested that it would be useful to conduct marketing surveys to develop a better understanding of their industry.

Agro-processing businesses said that access to timely information was important for them as prices of some of their input commodities fluctuated, which caused them real stability concerns. Large businesses usually secured market information by leveraging their contacts across their respective supply chains. Businesses said that the government had no plans to improve market information within their industry and that currently market intelligence was limited.

Gender Specific BER Issues for Horticulture & Agro-processing

Management teams and CEOs of all firms interviewed were male. In order to explore BER gender angles, all firms interviewed were asked about how many women were employed in their business and their attitudes toward employing women. Some findings relating to these discussions are highlighted below:

- Horticulture trading SMEs interviewed did not employ any women and were not open to the idea of recruiting women. The reason for this was that they mostly work in male dominated fruits and vegetable markets where it would be difficult for women to work. Other aspects of their business involves moving and carrying horticulture produce from one location to another which was again perceived by them to be unsuitable activities for women.
- Large horticulture and agro-food processors interviewed did not have reservations about hiring women. In fact, one of the larger sugar manufacturers interviewed said they had a positive discrimination policy for hiring women where they could be employed effectively. It was, however, interesting to note that a leading horticulture processor employing over seven hundred employees said that they only had four women working across their various plants.
- Agro-processor firms interviewed said that they employed women at their plants and did not have any issues with employing women. Again, no women specific issues were reported that fall under BER functional areas.
- Where women were employed, it was mostly in departments that were more women friendly or gender neutral, such as the head offices rather than plant or factory units. The core businesses were handled by male employees.

Gender implications vary across different types of businesses. A serious issue with regards to gender was the systematic exclusion of women from participating in horticulture markets. This is true for employment of women in horticulture trading SMEs as well as for women being able to develop and run such companies.

Gender-specific BER issues don't stand out for these sectors because of the very thin participation of women in horticulture and agro-food sectors. For this reason, it would be advisable to conclude that it is premature to take a view of gender-specific BER issues, rather than to assume that there are no problems at all.

8.3 Review of regional/international best practices

This section provides information about approaches followed by other countries in successfully developing their agriculture (including, horticulture and agro-processing) sectors.

8.3.1 Brazil

Brazil's agricultural production has grown rapidly over the past two decades, driven by rising global demand, strong prices, and technological advances. Changes in crop management practices and expansion in the area harvested have enabled Brazil to become a leading exporter of soybeans, corn, sugar, meat, coffee, and ethanol. With continuing productivity increases and additional land available for farming, further growth in agricultural production and exports is anticipated. At the same time, growing per capita income and population growth will continue to fuel demand in Brazil for agricultural products, including higher value commodities.[66]

In 1994, Brazil's "Real Plan" introduced market-oriented reforms that included a reduction in the state's role in setting prices, managing production, and regulating trading of commodities. For the agriculture sector, this meant removal of quantitative restrictions and non-tariff barriers, as well as a generalised reduction of tariff barriers that resulted in a significant reduction in the price of agricultural inputs. Agricultural productivity was further boosted by sector-specific policies, such as the elimination or substantial reduction of price controls, subsidies and state monopolies. Minimum price guarantees were maintained solely for the purpose of price stabilisation and as parameters for rural credit policy.

Another important policy measure that had a wide-ranging positive impact was the Lei Kandir, which exempted exports of primary and semi-manufactured products from the state collected value added tax. A combination of agricultural research and availability of credit have further contributed towards agriculture sector development, raising productivity through technical innovation and providing access to those new technologies. These changes in policy served as a catalyst for agricultural modernisation in the country, and also served as an incentive for private sector investments in agricultural technology and efficiency improvements.

[66] http://www.ers.usda.gov/media/849055/err137.pdf

8.3.2 India[67]

India's horticulture production has increased substantially over the last two decades, and by 2013-14, it has increased by almost three times (2.87) since 1991-92. This has placed India among the foremost countries in horticulture production. During 2013-14, India's contribution in the world production of fruits and vegetables was 13.6 % and 14% respectively.[68] Total production of fruits during 2013-14 was about 89 million tonnes while that of vegetables was 163 million tonnes, whereas the third advance estimates put the production at 86 million tonnes and 167 million tonnes respectively for 2014-15.[69] The agro-processing industry is similarly growing and has attracted $6.5 billion in foreign direct investment over the past 14 years. This accounts for around 2% of the country's total foreign direct investment inflows. [70]

The Government of India has allocated nearly US$ 1 billion dollars under the Twelfth Five-Year Plan (2012-17), to implement various programs for the promotion and development of the food processing sector, including infrastructure development (food parks, integrated cold chain projects and abattoirs), quality assurance, codex standards, research and development, and human resource development. The Government has developed a policy framework that offers a broad set of incentives and support to investors in its food processing industry. For instance, the Government has simplified investment procedures in the food processing sector under the "automatic route," with simplified capital reporting procedures. The government is offering a number of other incentives, such as 100% foreign equity (for most products listed in the Consolidated FDI Policy 2015), tax breaks, and a reduction of import duty for processing plant equipment.

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67 http://gain.fas.usda.gov/Recent%20GAIN%20Publications/Food%20Processing%20Ingredients_New%20Delhi_India_12-28-2015.pdf

68 India's National Horticulture Database 2014

69 Source : FAO Website February 2015 (Data for 2012,2013) & For India : DAC (Data for 2013-14)

70 http://gain.fas.usda.gov/Recent%20GAIN%20Publications/Food%20Processing%20Ingredients_New%20Delhi_India_12-28-2015.pdf

8.3.3 Chile[71]

Chile has followed an export-oriented model for the development of its food processing industry. Processed foods have become the most important sub-sector within the country's manufacturing sector and account for 30% of the manufacturing GDP. Chile is a leading exporter of high-value products like wine, fruits, olive oil, salmon and trout. The country's food industry employs approximately 20% of its population and plays a vital role in generating foreign exchange through exports. Food exports have grown at an average annual rate of 10% over the past decade and the country supplies over 150 countries with fresh and processed foods and beverages.[72]

Agricultural sector along with related downstream activities have played a key role in Chile's economic success through rapid export growth. Since 1990, Chile's agricultural policies have focused on three main objectives: increasing competitiveness; achieving balanced agricultural development by integrating smaller farmers into commercial supply chains; and working towards environmental conservation through sustainable use of resources. Moreover, the country utilised its trade policy as a key instrument for stimulating export growth. Here, Chile used a combination of low tariffs, the removal of non-tariff barriers, and the strategic use of free trade agreements to successfully develop and establish markets for its exports.

8.4 Recommendations

Specific recommendations for the BER functional areas and proposed set of interventions that the government can undertake are provided below.

8.4.1 Quick wins

Public-private dialogue

The Department of Agriculture stated that their only priority was to assist farmers, and that they were not organised to cater to the needs of the agribusinesses. The growing importance of this subsector requires the Department to develop a better mechanism for eliciting feedback from these businesses, especially during the policy development and planning process. The Department should work towards establishing a formal PPD mechanism which allows it to secure feedback from a variety of agribusiness stakeholders, including businesses (large and SME), business associations as well as

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[71] OECD Agriculture Review – Chile, 2008

[72] FAO, UN

consumers. Currently, PPD is carried out in a patchy manner which results in many of the key stakeholders feeling disenfranchised, especially the smaller players.

Access to market information

The Department of Agriculture should initiate a series of consultations with large and SME businesses, as well as industry and business associations (including Pakistan Farmers Association, and LCCI), to identify market and commodity information which they need. For instance, Department of Agriculture can look for ways to collect and disseminate data as part of its Agriculture Marketing Information System.[73] This may involve developing a customised module and enhancing the existing functionality of the system to provide real time access for market information to producers and businesses.

Simultaneously, the Department should work with private sector entities that can develop information platforms for the agribusiness market, such as its existing technology partner Telenor who is already providing informational products to farmers to develop an information platform for agribusinesses.

Department of Agriculture should also initiate awareness sessions for businesses and associations where stakeholders are informed about type of support they can receive from entities, such as PBIT.

8.4.2 Medium to Long Term – Provincial Government interventions

Quality of Governance

Ineffectiveness of Market Committees is a well-established fact. These entities are meant to play a key role in management and oversight of the fruits and vegetable markets, however, they do not have the right capacity or resources to do so. It is time for the Department of Agriculture to conduct a review of the performance of these Market Committees and their ability to deliver the support needed within their markets. The Department of Agriculture, in collaboration with the Law Department, should review powers vested in these committees and assess whether they have sufficient financial and technical resources available to fulfil their mandate, and the process and criteria for how committee members are inducted. It is important for the Department to secure feedback from agribusinesses (both, large and SME) and business associations throughout the review process.

[73] www.amis.pk

GoPB can also consider establishing a monitoring unit that tracks performance of market committees on an on-going basis. It will also be useful to provide a formal feedback loop (e.g., helpline) that will allow market participants and businesses to provide feedback.

8.4.3 Provincial Government to Advocate with Federal Government

The Provincial Government should lobby FBR to review the manner in which tax liabilities are calculated for horticulture SMEs. The agency should not use turnover in the business bank accounts as a basis for calculating tax.

9. Livestock

9.1 Livestock Overview

During 2014-15, the livestock sector contributed 11.8% to the national GDP.[74] The sector experienced an annual growth rate of 4.1% and this was fuelled by population growth, urbanisation, increases in per capita income and export opportunities. The sector covers a variety of sub-sectors and activities, however, the focus of the analysis is on development of two key sub-sectors: dairy and poultry. Provided next is information, analysis and recommendations for developing the dairy and poultry sub-sector in Punjab.

9.1.1 Dairy Overview

Dairy farming in Pakistan is characterised by fragmented, smallholder farmers operating at subsistence level. Around 8.5 million people are associated with the dairy industry. The sector produces 40 billion litres of milk annually. Recent annual increases in milk demand have been 15%, but production has grown at just 5%. The rising trend in dairy prices serves as a great incentive for producers and investors to raise production levels in this sub-sector.

Production

More than 96% of the milk produced in Pakistan comes from cattle and buffalo. Development started during the 1980s, with the establishment of rural dairy farms. These farms were run on a commercial basis and typically had 30 animals, of which 70% were females, including some cows. Growing demand for milk in urban areas forced a relocation towards peri-urban areas.

Despite being one of the world's largest producers of milk, Pakistan is still a net importer of dairy products. Pakistan is sufficient in milk production but the issue is with the milk supply chain and difficulties distributing milk nationwide.

Demand

Demand has increased at a rapid pace due to the rising population, increased incomes, and changes in consumer preferences towards livestock and dairy products.

[74] Economic Survey of Pakistan

An increasing urban population, more educated consumers and an emerging middle class has also helped increase the growth of packaged liquid dairy products (LDP) by 19% per annum between 1999 and 2009.[75]

A breakdown of household expenditure in Pakistan shows that milk and dairy products form one of the biggest portions of kitchen expenditure (22%, compared to wheat at just 12%).[76] Milk products also have a 7.4% weight in the Consumer Price Index, while wheat is 4.2%.

Imports

Due to shortages in milk supplies, Pakistan has to import powder milk from various countries. Imported milk powder volume has increased from 35,512 tonnes (worth US$ 115 million) in 2014 to 45,912 tonnes (worth US$172 million) in 2015, almost doubling in terms of value.[77]

9.1.2 Poultry Overview

Poultry remains one of the fastest growing sectors in the agricultural industry in Pakistan. It contributed 1.4% to GDP during 2015-16, while its contribution in agriculture and livestock value added stands at 6.9% and 11.7% respectively.[78] In the past three decades, poultry farming has emerged as an important sub-sector of livestock, with a sustained average annual growth rate of 8% to 10%. Overall, the sector's annual production has now reached 1.2 billion birds a year (doubling since 2010-11), or 2.4 billion kilograms of meat with almost 10 billion eggs per annum.[79] The sector is worth PKR 750 billion, provides employment (through its production and sales chain) for close to 1.5 million people across the Pakistan[80]. Punjab accounts for almost 73% of poultry production activities in the country.

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[75] Milk is consumed as fresh, boiled, powdered and in processed form like yogurt, ghee, lassi, butter, cheese, ice cream, sweets and in other confectioneries.

[76] http://nation.com.pk/business/29-May-2016/pakistan-importer-of-dairy-products-despite-3rd-largest-milk-producer

[77] Pakistan imports milk powder, namely from India, New Zealand, US and France. India remains the top milk powder exporter to Pakistan.

[78] Economic survey 2015-16

[79] Economic Survey 2015-16

[80] http://www.pakistanpoultryassociationnz.pk/statistic-of-ppa/

Pakistan exports from the poultry sector were almost $25 million from live birds, meat and eggs in 2015, with exports of eggs growing to over $20 million from just $8.9 million in 2014.[81]

Production

Poultry in Pakistan is being developed through two management systems; commercial farming and rural poultry farming. There has been a shift away from rearing chickens in traditional open houses to rearing them in semi or completely closed automated houses[82]. Commercial poultry production was initially concentrated around the large urban centres of Karachi and Lahore. Today, poultry farms have been established across Punjab, particularly in Rawalpindi, Faisalabad, Multan, Lahore, Bahawalpur, Rahim Yar Khan and Mianwali. Large-scale investments have resulted in the establishment of 25,000 commercial poultry farms across Pakistan and 150 feed mills with the capacity to produce 2,821 million tonnes of compounds feed per annum.[83]

The commercial poultry-farming sector is a classic example of private-sector led growth. This growth was possible due to incentives granted by the Government, such as liberal financing and credit, income tax exemption and duty-free imports of grandparent and parent flocks,[84] machinery and poultry farm equipment and feed ingredients.

Demand

Investment in poultry farming and expansion of the sales network of poultry meat in the last few years has given a boost to local sales and made it the cheapest meat available in the country. Poultry meat helps meet almost 40% of the country's protein requirement.[85]

The World Health Organisation (WHO) estimates the daily requirement of animal protein is 27 grams per person, whereas Pakistanis consume only 17 grams. Per capita poultry meat consumption currently stands at only five kilograms and 51 eggs

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[81] Source: UN Comtrade

[82] http://www.foodjournal.pk/July-August-2013/July-August-2013-PDF/Exclusive-Poultry-Dr-Noor.pdf

[83] Economic Survey 2015-16

[84] The life of a chicken rose for meat starts at the breeder farm. There are strict biosecurity regulations for importing the eggs, which are incubated and hatched in quarantine. The hatchlings become the great-grandparent flock, which produce grandparent stock, which in turn produce parent stock – it is the offspring of the parent stock that are raised for meat production.

[85] Economic Survey 2015-16

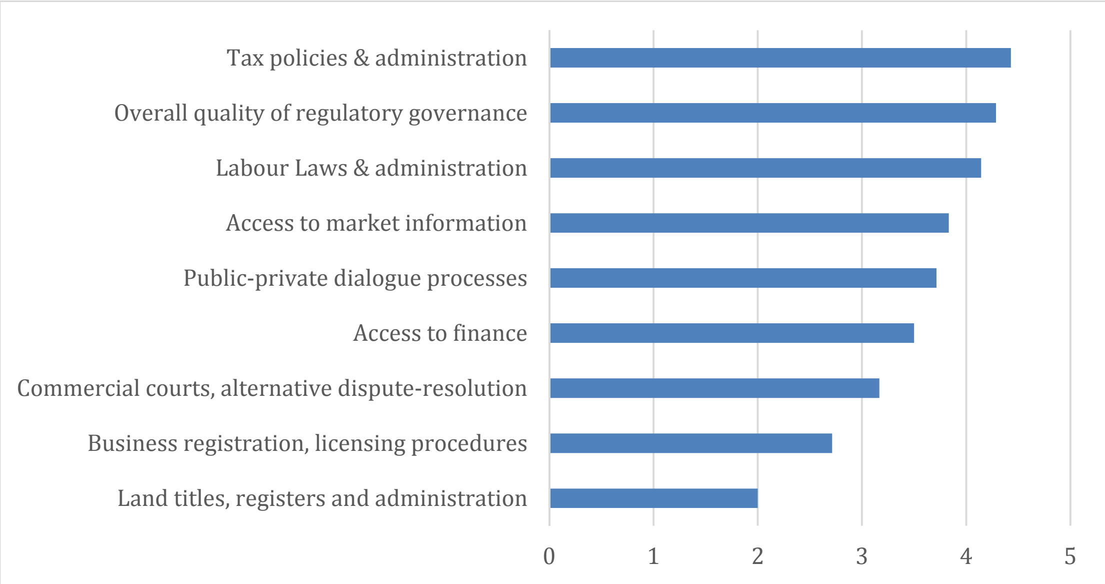
per annum, compared with 40 kg and over 300 eggs per capita per year in developed countries. Thus there is still great scope for the home market to increase its consumption levels.

The opening up of fast food chains by local and global brands and continued establishment of local restaurants and eateries has also contributed to higher consumption of value-added poultry meat products. Of late, vertically integrated poultry and ready-to-cook food sector companies have started making their presence felt in local sales and exports of chicken-based food products.[86]

9.2 Livestock Diagnostic Section

In assessing the impact of the current business environment on BER functions, the BERF team secured input and feedback from a group of four milk processors and four poultry businesses. Firms were also asked to rank the BER functions in order of the severity with which they impede businesses. Rankings of BER functions by livestock businesses is shown in Figure 8.1 (below). Tax policies and administration, overall quality of regulatory governance and labour laws and administration were reported by firms as the most serious impediments to business.

Figure 9.1: Livestock BER rankings



Source: Interview data

[86] K&Ns, MonSalwa (Quick Food Industries) and Season's Menu

Provided next is a discussion of sector specific issues faced by dairy and poultry businesses. This section extends the discussion of Chapter 2, by providing sector-specific details for those constraints that were seen to be particularly problematic for the livestock sector. The common constraints discussed in Chapter 2 that apply equally to the livestock sector are not repeated here.

9.2.1 Business registration and licensing procedures

Dairy businesses reported improvements made to the registration process by SECP. However, for new products, there are several issues that the dairy operators face and these are highlighted below:

New Product Regulatory Compliance (Regulatory & Administrative Framework)

Government approval is not required when rolling out a new dairy product into the market. The onus here is on the dairy operators to comply with applicable standards and food laws.

Multiple Regulatory Bodies (Institutional Arrangement)

Whereas PSQCA regulates standards at the Federal level, the Punjab Food Authority (PFA) has a separate, and at times divergent, set of standards. This makes it difficult for the dairy operators to sell the same products nationwide and increases their cost of compliance.

New entrants into their industry need to be compliant with the Punjab Poultry Production Act 2013 and Punjab Environmental Protection (Poultry) Regulations 2013.

Punjab Poultry Production Act 2013

Poultry premises should be located at a distance of one kilometre from another broiler farm. The distance between farms is important for maintaining bio security and preventing diseases. These guidelines are not adhered to and one can invariably find different broiler farms operating next to one another.

Punjab Environmental Protection (Poultry) Regulations 2013

This regulation contains stringent procedures and guidelines for poultry businesses. Much like the Punjab Poultry Act 2013, the enforcement of the Punjab Environmental Protection Act 2013, leaves a lot to be desired. For instance, the law requires a new entrant into the poultry business to undertake a rigorous environmental assessment prior to registration. In reality, the environmental assessment is a fifty page document that can be easily purchased from a market.

9.2.2 Tax Policies and Administration

The Government's stance on tax policies is causing significant concern across the dairy sector. Some of the key issues are outlined below.

Changes to Tax Policies (Legal & Policy Framework)

Previously, milk was zero-rated, however, in the recent budget (2016-17) it was made tax exempt. In theory, this allows the dairy operators to reclaim taxes they have paid on inputs. In practice, the Government has not released refunds owed to the industry. Estimates shared by dairy operators suggest that as much as PKR 16 billion to PKR 18 billion in refunds are being held by the Government. These costs have affected dairy operators and substantially add to their cost of doing business.

Taxation on Imports (Legal & Policy Framework)

In a bid to discourage dairy sector imports, the Government has increased import sales tax on inputs from 25% to 45%. This has made it uncompetitive and unviable for certain dairy sector operators, and this can have far reaching effects.

As agricultural products, poultry is exempt from withholding tax as per income tax ordinance 1979.[87]

Provided below are some issues relating to tax policies and their administration that surfaced during consultations with poultry businesses.

Sales Tax Registration

Sales tax registration for a poultry business is secured after the entity begins production. So, if the business has to import machinery, they will have to pay the sales tax that will be readjusted or refunded afterwards. As poultry is a food item, it is tax exempt, and as such their businesses should not be expected to pay taxes only to obtain a refund. Levying sales tax puts a financial strain on businesses and industry believes that sales tax registration should happen as soon as a business is registered.

[87] The relevant exemption under serial (v) of SRO 586 (1) 91 of Income Tax Ordinance 1979 states as under: "Persons receiving payments from a company exclusively for the supply of agricultural produce (including fresh milk, live chicken bird and eggs) by any person engaged in poultry farming and by an industrial undertaking engaged in poultry processing which has not been subjected to any process other than which is ordinarily performed to render such produce fit to be taken to market"

Sales Tax on Soybean Meal

Currently, soybean meal is not produced in Pakistan and the poultry sector imports this to meets its requirement. Soybean meal is a rich source of vegetable protein and constitutes over 15% of poultry feed and accounts for around 70% of the total cost of poultry production cost. In the Federal Budget 2014-15, government introduced a 5% import duty and a 5% sales tax on soybean meal. Poultry businesses would like the Government to reconsider imposing these taxes as it considerably increases their costs of production. They said that the impact on the sector as a result of the soybean meal tax is roughly PKR 10 billion.

Sales Tax Exemption on Poultry Machinery & Equipment

Through a notification (SRO 727(1)/2011), the Federal Government granted a concession on sales tax on the import of plant and machinery for the poultry sector. During the import stage, the poultry businesses should deposit funds with the customs authorities, equivalent to 12% of the value of imports which can be reclaimed by providing evidence, such as, a sales tax return. Poultry businesses would like this requirement to be scrapped as this makes it difficult for businesses to import machinery and equipment.

9.2.3 Access to Finance

Poultry is a capital-intensive industry, and it is important for businesses operating in this sector to have access to resources and support from the financial sector.

Financing Perishable Items

A change in SBP policies is desired by the poultry sector. The policy framework needs to accommodate key characteristics of the poultry business, such as its specific life-cycle and perishable products. Banks do not adequately understand the way the industry operates, especially the day-to-day changes in prices of poultry, and ask for loan repayment if poultry prices fluctuate.

A poultry sector SME noted that they were working towards securing term financing as per guidelines set out by SBP for poultry financing. Despite qualifying as per the SBP's criteria, the private bank they were working with to secure financing was not able to offer them financial support. They were of the opinion that, for SME poultry businesses, securing financing from banks is a challenge as the banks are unwilling to lend to smaller businesses and operate against a different set of priorities. The SME in question had to turn to private investors to raise the needed capital.

SBP Policy

SBP policy is that if an outstanding loan is not repaid in a certain time then the Credit Information Bureau is informed. The poultry businesses said that given the special characteristics of their market and product (e.g., cyclicality, perishability, etc.), these businesses should be allowed an extended grace period (180 to 260 additional days) before their loans are put in default. They understood that misuse of loans did take place and to counter this SBP has strengthened their prudential regulations but current practices hurt genuine private sector businesses that are in need of financing.

9.2.4 Labour Laws and Administration

In general, larger and more corporate dairy sector operators provide a range of facilities and benefits for their employees. As these employees are paid above the minimum wage, these entities have limited interaction with the labour department.

A poultry SME interviewed which owned their own retail outlets said that the Labour Department inspectors ask them to produce a physical register and cannot accommodate their computerised systems are computerised. As they are unable to produce a physical register, fines are levied upon them by the Labour Department.

9.2.5 Quality of Governance

Devolution following the 18th amendment created overlapping regulatory bodies and, at times, contradictory standards. Federal, provincial and Cantonment regulatory bodies follow different rules and do not talk to each other. Compliance is a concern, especially for larger dairy sector operators, as they cannot by pass these rules. Smaller dairy businesses can generally get away with non-compliance, which results in them having lower production costs. Differing standards and multiple regulatory bodies creates confusion and results in dairy operators not being able to sell some of their products in certain jurisdictions.

Non-Uniform Regulatory Standards (Legal & Policy Framework)

Lack of standardised policies makes it difficult for dairy operators (especially those operating nation-wide) to comply with regulations. For instance, the definition of milk differs from one place to another e.g., milk that has a 2.5% milk fat content and which is healthier cannot, in some places with a 3.5% threshold, be called milk.

<u>Regulating Milk Chillers (Legal & Policy Framework)</u>

The Punjab Food Authority enacted the Punjab Pure Food Rules (2011) to regulate and manage the operations of milk chillers across the province. However, milk chillers also come under the purview of the District Coordinating Officers (DCOs) as per a law from the 1960s. According to the large dairy sector operators, the DCOs routinely use these powers to collect "fees" from businesses that operate milk chillers. Non-payment of such fees results in confiscation of milk chillers and this costs them several days of production being wasted, at least three times a year.

Counterproductive Regulatory Standards (Legal & Policy Framework)

According to dairy sector operators, about three years ago, an SRO was issued which made it mandatory for the dairy operators to use bio-degradable chemicals in all plastic packaging of their products (including caps and bottles). However, these chemicals, used in plastic bags, are not appropriate for packaging food items as they could disintegrate, especially in cases of products that have a longer shelf life.

Regional Languages (Regulatory & Administrative Framework)

Punjab Food Authority and health department issued notices to dairy sector operators that they should use regional languages on the packaging of their products. This increased costs for the dairy businesses to move goods from one region to another.

9.2.6 Public Private Dialogue

There are several avenues available to the dairy businesses for engaging with the Government. Government often invites dairy businesses, especially larger ones, to a dialogue or consultation on broader industry issues. Dairy companies are currently engaging with the Government on a law on the pasteurisation of milk. Larger dairy businesses tend to be more active in their lobbying efforts than the smaller dairy business.

Poultry businesses have been involved in dialogue with a number of government agencies, but found it was difficult to maintain a productive dialogue with these bodies due to high turnover of key public sector bureaucrats, such as the Secretary of Agriculture and Director TDAP.

9.2.7 Access to Market Information

Dairy businesses have limited access to any information about demand and supply; consumer preferences; and income distribution. The businesses were not in favour of using unreliable government statistics. Instead, they wanted a private sector led informational platform to be developed, much like the agriculture sector where phone companies provide real time access to market prices and information.

Gender Specific BER Issues for Dairy & Poultry

Management teams and CEOs of all firms interviewed were males. In order to explore BER gender angles, all firms interviewed were asked about how many women were employed in their business and their attitudes towards employing women. Some findings relating to these discussions are highlighted below:

- Dairy businesses interviewed did not have any problems in recruiting women. One of the Larger dairy business offered a number of benefits to its female employees, such as a crèche, paid maternity leave, and a dedicated car park. Still, only 7% of their 4,228 employees were women.
- Poultry businesses interviewed said that women were usually employed at their head office. Women employees represented 5 to 15% of their total work force. Again, similar to agribusiness sector, women were generally employed in departments where the work environment was considered more female friendly or gender neutral, such as the head office, rather than at the factories or production plants. This was due to the fact that labour had to work night shifts or production plants were situated in places further away from the city.
- Those that did provide a conducive work environment for women did so to comply with international standards rather than to meet any standards put in place by the provincial or federal government.

There is a lack of female participation in dairy and poultry businesses and government does not have an active agenda to promote women employment in these sectors. One of the reasons for this is that businesses have to offer more facilities for a female workforce.

Only larger brands such as Nestle can afford to launch special programs to encourage women employment as they already are meeting the basic standards to provide a good work environment for women. Women Agripreneurship is one of the many initiatives under which more than 10,000 rural women have been trained on best Dairy Farm Practices.

Gender-specific BER issues don't stand out for these sectors because of the limited participation of women in dairy and poultry sectors. It is premature to take a view of gender-specific BER issues.

9.3 Review of Regional/International Best Practices

This section provides information about approaches followed by other countries in successfully developing their livestock (including, dairy and poultry) sectors.

9.3.1 Dairy Best Practices

Kenya

Kenya's dairy sector is small-holder based with a strong commercial orientation. Those with one to three cows produce 80% of the milk and the poorest group earns approximately half of their earnings from milk sales. The dairy industry accounts for 14% of agricultural GDP and 6-8% of the country's GDP.[88]

In the 1990s, the Kenyan government embarked on liberalising the dairy sector by phasing out government interventions; maintaining self-sufficiency in milk and dairy products; allowing for smooth transition from government interventionism to a free market; and, creating a conducive environment for milk production and marketing. This liberalisation brought about changes in the manner in which milk and dairy products were procured, handled and marketed, and resulted in new entrants into the dairy market, which was previously controlled by Kenya Cooperative Creameries, a quasi-governmental milk processor. Adopting a private sector led development approach had a multiplier effect in increasing the numbers of larger and formal processing entities as well as numbers of informal milk traders.

India

India is the world's largest producer of dairy products by volume and accounts for 18% of world's total milk production.[89] The country's dairy sector witnessed exceptional growth between 1971 and 1996 and this period is also known as the Operation Flood era. Operation Flood involved the development of an integrated cooperative programme that was aimed at developing the dairy industry and was implemented in three phases, with The National Dairy Development Board designated by the Government of India as the implementing agency. As part of this programme, around 10 million farmers were enrolled as members of approximately 73,000 milk cooperative societies. Since its implementation, milk production increased from 21 million tonnes in 1970 to nearly 69 million tonnes in 1996, at the compound growth rate of 4.5%.[90]

In 2010, the Government has developed a National Dairy Plan (NDP) that aims to nearly double India's milk production by 2020, by increasing the country's milk productivity; improving access to quality feeds; and, improving farmer's access to organised markets. These goals will be achieved through interventions that focus on increasing cooperative membership and growing the network of milk collection facilities across the country. Complementing these efforts, the Government, in 2006 has also

[88] http://foodbusinessafrica.com/index.php/resources/industry-features/512-the-dairy-industry-in-kenya?showall=

[89] FAO, UN

[90] http://www.iuf.org/sites/cms.iuf.org/files/Indian%20Dairy%20Industry.pdf

established the Food Safety and Standards Authority of India (FSSAI) and consolidated previous policies that set sanitary requirements for food safety, machinery, premises, quality control, certification, packing, marking and labelling standards for all food products, including milk and milk products. In addition to these BER reforms, the country has also embarked on an aggressive agenda of increasing private sector investments in its poultry industry and is offering, through its program Make India, a specialised set of incentives, such as, tax incentives, sales tax exemption, breaks on import duty, 100% FDI allowance and credit facilities.[91]

9.3.2 Poultry Best Practices

Sri Lanka

Over the last three decades, the poultry sector in Sri Lanka has evolved from backyard activity into a full-fledged commercial poultry industry. Commercial poultry farming activities contribute 70% of value-added to the livestock sector. The poultry sector is capable of producing enough to satisfy domestic demand for chicken meat and eggs. Current per capita availability of chicken meat and eggs estimated to be 4.8 kg and 57 eggs respectively. There are four distinct rearing systems in Sri Lanka: intensive large-scale operations; semi-intensive medium scale operations; small-scale scavenging village chicken system; and a buy back (contract) rearing system

Growth of the poultry industry can be traced back to the 1950s when the Government launched a program to upgrade local and indigenous poultry population in the country. Currently, the industry is private sector-led and the role of the Government is confined to implementation of poultry health management programmes, research and policy development. Over the last two decades, the country has implemented major policy reform measures to create a competitive environment for its livestock sector. To this end the Government has purposefully embarked upon liberalising trade and streamlining regulatory requirements. For instance, the Government does not require any licenses, permits or other government administered requirements, other than those needed for technical reasons, for trading of livestock products and inputs. Similarly, pricing for livestock production inputs and products is also left to be determined by competitive market forces.

India

Poultry is one of the fastest growing agriculture sector segments in India and has been growing at a rate of 8% to 10% annually. During the last decade many poultry

[91] www.makeindia.com

businesses have vertically integrated their operations (also called integrators), especially in southern and western regions of the country. An estimated 60%-70% of all businesses use the integrator model, while the remaining are smaller backyard operations. Typically, integrators own their own hatcheries, feed mills, and slaughter facilities. They also contract with multiple smaller farmers who raise the chicks to slaughter weight primarily in open air sheds. Some integrators also provide credit, extension services, and veterinary medicine.

As discussed in dairy above, the FSSAI also regulates domestic poultry slaughter and processing sector through the Food Safety and Standards Regulations. This regulation covers all stages of poultry production and requires registration and licensing of poultry processors and other food operators in the poultry value chain. In addition, Make India (discussed above in dairy) also targets the poultry sector.

9.4 Recommendations

Specific recommendations for the BER functional areas and proposed set of interventions that the government can undertake are provided below.

9.4.1 Quick wins

Multiple Regulatory Bodies (Institutional Arrangement)

Dairy businesses voiced concern over the different, and at times divergent, standards being enforced by PSQCA and PFA. Ensuring compliance with two sets of standards stops them from selling certain products in certain jurisdictions. PFA should work with PSQCA to correct instances where the two regulatory standards are at odds. The Pakistan Dairy Association has already developed analysis of the two standards and have compiled a list where they have identified inconsistencies between them. PFA can engage PDA to speed up this process and to secure feedback on any changes.

Public-private dialogue

Much like Department of Agriculture, the Department of Livestock's only priority was to assist livestock producers, and they were not organised to cater to the needs of livestock businesses. A varied landscape and growing numbers of livestock businesses makes it important for the Department to engage these businesses in the PPD process. The department conducts PPD sessions with some livestock businesses (mostly large dairy firms) as well as business associations, however, these consultations are irregular and unorganised. The increasing economic importance of the livestock industries makes it important for the Department of Livestock to establish a formal PPD mechanism for securing feedback from key stakeholders, including different types and sizes of business entities, industry associations as well as consumers. Moreover, securing inputs from the industry can avoid past examples of counterproductive policy initiatives, such as calling for the use of biodegradable chemicals in the packaging and printing of regional languages on dairy products.

Access to market information

The Department of Livestock can start a dialogue with dairy and poultry businesses as well as industry and business associations (including PDA, PPA, LCCI) to identify their market information needs. Through these consultations, the department can explore ways to collect and disseminate data that the business community might find useful. Here, the Department can look into leveraging the livestock database system which the department has recently developed.

As was suggested for agriculture, the Department of Livestock can work with businesses and develop information platforms for dairy and poultry industries. For instance, the department can work with its existing technology partner Telenor to develop information platform for businesses.

Department of Livestock can initiate awareness sessions for dairy and poultry businesses as well as businesses associations where stakeholders are informed about the type of support they can receive from entities, such as PBIT.

9.4.2 Medium to Long Term – Provincial Government interventions

Punjab Poultry Production Act 2013 & Punjab Environmental Protection (Poultry) Regulations 2013

Laws are not being enforced properly due to weak enforcement capacity of the livestock department. Non enforcement of these laws increases bio security threats to both humans and animals. This takes added significance when poultry farms operate side by side, and close to human settlements. The Department of Livestock should establish an enforcement monitoring cell which is tasked with data collection and analysis. The monitoring cell can collect data and share this information with other relevant agencies once every three months. Having access to this information will enable GoPb executives to track how effectively the law is being implemented

Quality of Governance

The existence of multiple laws that govern the use of milk chillers is problematic for the dairy industry. PFA rolled out Punjab Pure Food Rules 2011 that provides guidelines for regulating milk chillers, however, this was without addressing the earlier law that provides DCOs powers to regulate milk chillers. Multiple regulators increases harassment, extortion and the cost of doing business. PFA should take a lead in calling for the removal of this duplication of authority over milk chillers. Relevant legislations should be modified or removed so that PFA is the only empowered regulatory authority that oversees the usage of milk chillers.

9.4.3 Provincial Government to Advocate with Federal Government

The provincial government can lobby FBR for timely release of refunds owed to dairy and poultry businesses. It should also lobby on behalf of dairy and poultry businesses on increases in taxation on their inputs. For instance, discuss with the Federal government the impact of the increase in sales tax on dairy sector imports (from 25% to 45%), as well as the impact of increasing sales tax on Soy Bean Meal on poultry production.

State Bank should work with commercial banks to develop and implement credit programs for the dairy and poultry industries. For instance, these schemes can be designed so that they take into account the perishable nature of these products, and could be offered in areas that have a large preponderance of dairy and poultry businesses.

10. Conclusions

Businesses in Punjab face a number of challenges across all aspects of the business environment. This study conducted interviews with selected businesses from each of the five priority growth sectors: garments, automotive, footwear, agriculture and livestock.

Those interviews revealed a number of cross cutting and sector specific constraints. Sectors were unanimous in identifying tax policy and administration as the biggest constraint to business. There are issues with tax policy that are common across all sectors, such as delays in refunds and uncertainty caused by unpredictable changes, and sector specific issues, such as high import duties on raw materials or high sales taxes on final products. The 18th Constitutional Amendment was, in part, designed to give greater devolved powers to the provincial government in the hope of seeing improvements in the business environment. As far as taxes are concerned, however, it has had the opposite effect, with the provincial tax authority duplicating federal taxes, and businesses having both higher tax and administration burdens.

Tax policy is not consistent with the economic growth ambitions set out in the Punjab Growth Strategy, and in many cases actively undermines broader objectives. It is highly concerning that tax authorities are incentivised to maximise short term revenues with almost complete disregard to the impact on the private sector, employment and longer term growth. Equivalent concerns apply to the Labour Department, whose mandate focuses on worker protection but at the expense of employment. The interpretation of these mandates may indeed be counterproductive, encouraging more firms to operate in the informal sector and beyond the reach of tax authorities and labour inspectors, where employment conditions and product standards are unregulated and potentially much worse.

This report has set out a number of recommendations to address specific constraints which the provincial government is able to influence. However, for Pakistan and Punjab to realise the levels of private sector investment and growth which it aspires towards, a much more fundamental shift is required in the way in which economic policy is formulated and implemented.

Government departments need better mandates which go beyond the narrow focuses and reflect broader growth aspirations. Tax authorities should not maximise revenues at the expense of growth. The Labour Department should not aggressively enforce unclear regulations at the cost to employment. These mandates need to be supported by incentive structures for employees which are carefully thought through and consider the potential unintended consequences: current regulations are more often seen as an opportunity for extortion than protection of workers or consumers.

Improved mandates should also support **improved coordination of policymaking** between different stakeholders. Tax policy should reinforce industrial policy objectives and those set out in sector specific strategies, such as the auto policy. Departments need to be better at sharing information, reducing duplication of registration and reporting procedures on the private sector. Coordination also needs to be better during enforcement, and Pakistan should look at countries who have streamlined inspections to reduce the administrative and financial burden on businesses.

Finally, **policy needs to be based on better evidence**. We have seen countless examples of policy decisions being made without a proper appreciation of their impact. Few government officials that we spoke to seem to have considered the competitive advantage that heavy-handed enforcement is giving to the unregulated informal sector. Tax policy decisions seem to be made spontaneously without a proper understanding of the value chains which they will affect. A better understanding of the impact of changes to policy and regulations will only come with more proactive involvement of the private sector at earlier stages of the policymaking process. There are positive efforts being made by the GoPb in PPD, but these will only succeed if businesses believe there is a real appetite across government for positive change.

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