Reforms for competitive markets in Pakistan

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Planning Commission of Pakistan

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A Background Paper for Planning Commission’s New Growth Strategy

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Introduction

The importance of open markets and competition has been expounded by economists and is rooted in theory that dates back to Ibn Khuldun. Improving markets through better domestic commerce, competitive agricultural markets and well-regulated industries can enable Pakistan to compete in foreign markets, generate trade and knowledge spillovers, as well as gain exposure to new technologies and management systems. There is no need to reinvent the wheel as existing international methods and technologies can be utilised by an open economy to achieve desired benefits. Moreover, existing technologies can be built upon to create new knowledge and ideas. The aim of the New Growth Framework (NGF) is to encourage competition, create opportunities and provide an enabling environment for Pakistani markets to flourish in an innovative and exciting new way.

Traditionally, Pakistan's growth strategy has been confused, while announcing export promotion in some sectors, it has relied heavily on import substitution in others. Consumers have paid the price for these policies, through taxation for export subsidies, high prices and sacrifice of quality goods, where import substitution policies prevail. Meanwhile, innovation and entrepreneurship have suffered as the incentives are skewed in favour of rent-seeking lobbyists rather than competitive markets.4

Domestic commerce, despite having a share of over 30 per cent in Pakistan's GDP and employing about 20 per cent of the total work force5, has never seen systematic and focused reform effort by the public or private sectors. In the case of agricultural markets and manufacturing and industry, the over-involvement of the government has often distorted prices, led to constrained productivity and discouraged private sector involvement.

Market development in Pakistan is impeded for several reasons:

- There is a high degree of government involvement in most markets ranging from agriculture to manufacturing, from retail to transport and from trading to construction.
- Government is a player as well as a competitor in many of these markets, making it difficult to define a transparent competitive market. It remains a dominant player with recourse to taxpayers’ funds and limits entry and competition.
- Government regulation in many markets is not professionally organised and informed by research, leading to contradictory and cumbersome regulation, and regulatory capture. Sometimes the regulator is taxing entry too heavily to maximise revenue at the expense of competition.
- Lack of consistency in government policy – importing commodity one year, buying from the local market next year—strengthens rent seeking at the expense of the consumer. Government policies, regulation and rules must be clear and consistent over time.
- Better configuration is required between the legal systems and economics—particularly in the case of property rights and sanctity of contracts.
- Ultimate incidence of public policy should be judged on welfare grounds—there should be no favourites and the focus should only be on increasing consumer welfare.

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Domestic commerce which defines value at the exchange point employs substantial work force but remains heavily taxed due to neglect. Yet it forms a critical part of the value chain compromising the quality of goods at the expense of export competitiveness.\(^6\)

This background paper of the New Growth Framework aims to introduce openness and competition in Pakistan’s domestic commerce, agricultural markets and industries and manufacturing sector. While detailing the problems and constraints faced in each of these sectors, this report also presents recommendations for future reform so as to increase productivity and promote economic growth.

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\(^6\) Ibid.
Quality of Domestic Commerce in Pakistan

Domestic commerce includes wholesale and retail trade, and warehousing and transport with several linkages between each of these activities. Historically, domestic commerce has played an essential role in providing a solid base to today's strongest economies. England for example, was known as 'a nation of shopkeepers' before the Industrial Revolution.\(^7\) Well developed and large scale domestic markets provide a testing ground for new products and techniques. New brands have greater chances of succeeding and becoming well known internationally when tested in well developed domestic markets. Leading international brands have flourished through availing opportunities in their home markets.

In Pakistan, the state of domestic commerce is partly apparent by the poor condition of the retail markets in our cities. They are mostly small, cramped and congested areas with limited square feet allocated to every shop. There is an excess demand for not only retail space but also office space, hotels and mixed use areas.\(^8\) Excess demand for office space is also evident by high rent prices.\(^9\) Due to these high prices as well as poor provisions for office complexes, a large number of offices, small businesses, guest houses and salons are operating illegally through residential areas. Besides the lack of proper commercial space, high commercialisation fees are also charged that raise investment costs considerably.\(^10\) Figure 1a below shows the share of domestic commerce activities in the GDP of Pakistan and Fig 1b shows the growth of these activities over the past decade.

![Figure 1: Share in GDP and Growth of Domestic Commerce](image)

Source: Economic Survey of Pakistan 2009-10

The combined share in GDP of wholesale and retail trade is about 18 per cent and of transport and storage is about 11 per cent. The share in GDP for both these sectors has remained relatively steady for the past ten years. The growth of wholesale and retail trade, however, has been unsteady with sharp ups and downs. There is a high correlation (about 64 per cent)\(^11\) between the growth rate of wholesale and retail trade and the overall GDP growth rate. The growth rate of commodity-producing sectors and merchandise imports is the key factor influencing the growth rates of domestic commerce. Figure 2a

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8 Mixed use development is the practice of allowing more than one type of use in a building or set of buildings. In planning zone terms, this can mean some combination of residential, commercial, office, hotels, institutional, or other land uses.
9 See Table 3 and Table 4
10 See chapter on ‘Cities as engines of growth’ for a more detailed exposition on high commercialisation rates in Pakistani cities
11 Correlation was calculated using data between 2000-2001 and 2009-2010
shows the share of domestic commerce in the overall employment in the country. Wholesale and retail employs 14.6 per cent of the total workforce while transport employs 5.5 per cent.

**Figure 2: Employment Share of Domestic commerce in Total Employment**

Figure 2b shows that 35 per cent of the people are employed in urban areas and 14 per cent of all workers in rural areas work in domestic commerce, giving a weighted average of approximately 20 per cent to all employed workers in Pakistan who work in domestic commerce.

Given the share in GDP and employment, it is surprising that no extensive research has been conducted on the socio-economic role of domestic commerce and there has been no attempt to develop a coherent policy framework for it.\(^\text{12}\) According to the Global Competitiveness Report 2010-2011, Pakistan ranks poorly in terms of domestic commerce measures: business sophistication, goods market efficiency as well as property rights protection. Comparison with other Asian countries shows that Pakistan ranks lowest when compared to India, Indonesia, Thailand, Malaysia and China. As shown in Table 1, Pakistan ranks 46 out of 139 countries in terms of business cluster development compared with India which ranks at 29 and China at 17.

<table>
<thead>
<tr>
<th>Countries</th>
<th>Cluster Development</th>
<th>Local Supplier Quantity</th>
<th>Local Supplier Quality</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pakistan</td>
<td>46</td>
<td>87</td>
<td>95</td>
</tr>
<tr>
<td>India</td>
<td>29</td>
<td>7</td>
<td>60</td>
</tr>
<tr>
<td>Indonesia</td>
<td>24</td>
<td>43</td>
<td>61</td>
</tr>
<tr>
<td>Thailand</td>
<td>34</td>
<td>26</td>
<td>43</td>
</tr>
<tr>
<td>Malaysia</td>
<td>15</td>
<td>29</td>
<td>37</td>
</tr>
<tr>
<td>China</td>
<td>17</td>
<td>19</td>
<td>54</td>
</tr>
</tbody>
</table>

Source: Global Competitiveness Report 2010-2011

Table 2: Goods Market Efficiency

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\(^{13}\) Lower number implies higher ranking out of 139 countries
In terms of goods market efficiency measures such as 'Intensity of Local Competition', Pakistan ranks a poor 87 out of 139 countries as compared with India that ranks 30 and China that ranks 19. Similarly, Pakistan ranks 106 in terms of 'Prevalence of Trade Barriers', which measures the extent to which tariff and non-tariff barriers limit the ability of imported goods to compete in the domestic market. The 'Degree of Customer Orientation' indicator measures how well companies treat customers in which Pakistan again ranks poorly. Consumer protection is almost non-existent in Pakistan and product quality is highly variable. Counterfeit items are readily available and some markets have earned a reputation for selling 'good-quality' counterfeits at much lower prices than the originals. This may be a deterrent to the entry of firms that charge a premium for their brand name.

Overall, there exists an unfriendly environment for domestic commerce. Reforms which induce enabling environments would encourage innovation and the development of brand names, in turn making available international quality goods at competitive prices to consumers. Moreover, jobs and skills will be created in modern warehousing, retailing and related supply chain networks which can boost regional incomes and welfare.

### Key Issues in Domestic Commerce

14 Study on Retail Markets, Innovative Development Strategies (IDS), 2006
15 Ibid.
Outmoded Urban Management and Zoning for Domestic Commerce

Urban management and zoning laws in Pakistani cities are beset by an anti-commerce bias. There is an emphasis on residential housing, specifically, large houses for the elite. Coupled with the restriction on ‘conversion’ of residential areas, a large number of offices, restaurants, schools and businesses are illegally operating through houses in these areas. In Islamabad, for example, commercial areas and parking are allocated just 5 per cent in private housing schemes compared to 55 per cent for residential housing. In Karachi as well, only 2 per cent of private housing schemes can be used for commercial activities which has now been raised to 5 per cent.

While it is cost effective for small entrepreneurs, professionals and independent contractors to work out of their homes (houses and apartments); nonetheless, the regulations and restrictions on the use of space have caused distortions in the commercial space market, leading to limited supply of space and high rental prices. This has resulted in small businesses having to work from homes because it becomes cost-effective for them to do so.

Excess Demand for affordable Retail and Office Space

There are several brackets for retail space demand depending on costs. For a new upcoming business, an affordable monthly rent may be between PKR 15,000 to PKR 30,000 whereas for a well-known established brand, an affordable monthly rent may range between PKR 80,000 to PKR 120,000. Of course, location plays a major role when deciding on retail space for a new business and prices vary immensely from central areas to outskirts of the city. In an interview with a young entrepreneur setting up a bakery in Islamabad, the only affordable retail space she could find was in E-11 for PKR 30,000 per month. Meeting with property dealers in Islamabad showed that there was a daily excess demand of about 300 retail shops (with rents below PKR 40,000 per month).

Table 3: Excess Retail Space Demand in Islamabad

<table>
<thead>
<tr>
<th>Sectors</th>
<th>F-8</th>
<th>F-6</th>
<th>F-7</th>
<th>F-10</th>
<th>F-11</th>
<th>G-6</th>
<th>G-7</th>
<th>G-8</th>
<th>G-9</th>
<th>G-10</th>
<th>G-11</th>
<th>Aabpara</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>No. of Property Dealers</td>
<td>12</td>
<td>14</td>
<td>15</td>
<td>9</td>
<td>11</td>
<td>5</td>
<td>3</td>
<td>4</td>
<td>16</td>
<td>11</td>
<td>3</td>
<td>23</td>
<td></td>
</tr>
<tr>
<td>Daily Clients for shops</td>
<td>2</td>
<td>4</td>
<td>4</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>3</td>
<td>4</td>
<td>2</td>
<td>4</td>
<td>5</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Daily Demand</td>
<td>24</td>
<td>56</td>
<td>60</td>
<td>18</td>
<td>33</td>
<td>20</td>
<td>9</td>
<td>12</td>
<td>64</td>
<td>22</td>
<td>12</td>
<td>115</td>
<td>445</td>
</tr>
<tr>
<td>Vacant Shops Available</td>
<td>6</td>
<td>18</td>
<td>23</td>
<td>10</td>
<td>20</td>
<td>11</td>
<td>5</td>
<td>4</td>
<td>20</td>
<td>10</td>
<td>7</td>
<td>15</td>
<td>149</td>
</tr>
<tr>
<td>Excess Demand</td>
<td>18</td>
<td>38</td>
<td>37</td>
<td>8</td>
<td>13</td>
<td>9</td>
<td>4</td>
<td>8</td>
<td>44</td>
<td>12</td>
<td>5</td>
<td>100</td>
<td>296</td>
</tr>
</tbody>
</table>

Source: Interviews with property dealers

The approximate rental value for office spaces per sq. ft. per month is presented in Table 4.
Table 4: Approximate Monthly Rental Values per sq. ft. (2008)

<table>
<thead>
<tr>
<th>City</th>
<th>Rupees</th>
<th>US$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Islamabad</td>
<td>65 - 200</td>
<td>1.03 - 3.00</td>
</tr>
<tr>
<td>Lahore</td>
<td>45 - 150</td>
<td>0.71 - 2.38</td>
</tr>
<tr>
<td>Karachi</td>
<td>80 - 150</td>
<td>1.28 - 2.38</td>
</tr>
<tr>
<td>Karachi (Finance &amp; Trade Centre)</td>
<td>150 - 250</td>
<td>2.38 - 3.98</td>
</tr>
<tr>
<td>Peshawar</td>
<td>35 - 100</td>
<td>0.55 - 1.59</td>
</tr>
<tr>
<td>Quetta</td>
<td>30 - 80</td>
<td>0.47 - 1.27</td>
</tr>
</tbody>
</table>


According to the prices above, a small office space of 12 x 38 square feet is rented out for between PKR 29,640 (minimum) to PKR 91,200 (maximum) in Islamabad. In addition to high prices, maintenance of current commercial areas has been severely neglected resulting in a drastically deteriorated outlook, with existing maintenance standards lacking efficient implementation. Commercial development is also discouraged through high commercialisation fees\(^1\). Mixed-use areas are also missing from zoning laws.

The productivity of a city and employment generation needs more entertainment, hotels, shopping areas and offices in large complexes, but no space has been provided for development of large complexes. Moreover, height restrictions imposed by regulatory bodies discourage high-rise buildings, which have resulted in small and congested shopping areas that provide unsatisfactory shopping experience. In Islamabad for example, buildings in commercial areas are restricted to a maximum of six storeys\(^2\). No space is provided for the poor entrepreneur (khokhas, rehri-walas etc.). The slow litigation process has led to many landlords keeping their premises empty and not renting it out due to the fear of illegal occupation beyond lease period and default of rent.

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**Box 1: Construction, Demand and Employment in the Hotel Industry: A Case Study of Islamabad Serena Hotel**

In 2002, Islamabad Serena Hotel was opened after three years of construction, after an unsuccessful attempt by the Aga Khan Group to acquire the Prime Minister Secretariat as a potential hotel. After initial problems with acquiring land for the project, the land was eventually acquired in an open bid advertised by the Capital Development Authority (CDA). The construction of the hotel generated considerable employment with an average of 400 people employed at all times. The employment ranged from 100-150 people in the non-peak times to 800 at the peak times. Currently, the total number employed by Serena Islamabad is around 750.

Serena has recently set up a business complex where it leases out small offices or entire floors to offices. These spaces are rented out at USD 3 per sq ft (unfurnished) to USD 7 per sq. ft (furnished) with an average section ranging from 7000 sq. ft to 12,000 sq. ft. Although the business complex is proving to be a profitable venture, operating at an almost 100 per cent occupancy rate, the rates are unaffordable for small Pakistani businesses. The main clients are only high-end firms including international donor agencies and multinational corporations.

There are currently four restaurants operating in Serena and another 2-3 more restaurants are planned by the end of next year, bringing the total of restaurants in the hotel to six or seven. The banquet halls cater to conferences, weddings, parties and other important events and are also a major source of revenue for the hotel. The regulatory problems encountered by Serena in dealing with the public sector have stemmed from mismanagement of government agencies, as well as a lack of coordination among government agencies.

Source: Based on interview conducted with General Manager, Mr Peter Hill and General Manager Projects, Mr Kabeer Malik

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Urban management roles and responsibilities are also not well defined with too many regulatory bodies operating in major cities. In Karachi, for example, there is the Karachi Building Control Authority (KBCA), the Defence Housing Authority (DHA), six cantonments and several private housing societies, among

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\(^1\) S Kardar, ‘Building Regulations’, presented to Planning Commission Task Force on Urbanisation, 2010

\(^2\) Ibid.
Box 2: Islamabad Residential Scheme Planning Standards

CDA has outlined the following standards for residential schemes being built in zones 2, 4 and 5:

<table>
<thead>
<tr>
<th>Component</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Residential</td>
<td>55 per cent</td>
</tr>
<tr>
<td>Open/Green Spaces/Parks</td>
<td>08 per cent</td>
</tr>
<tr>
<td>Roads/Streets</td>
<td>26 per cent</td>
</tr>
<tr>
<td>Grave Yards</td>
<td>02 per cent</td>
</tr>
<tr>
<td>Commercial and Parking</td>
<td>05 per cent</td>
</tr>
<tr>
<td>Public buildings</td>
<td>4 per cent</td>
</tr>
</tbody>
</table>

Emphasis is on residential housing with only 5 per cent allocated to commercial areas and parking resulting in small and cramped shopping areas


Box 3: Karachi Building Regulations for Commercial Areas

Building regulations play an important role in promoting domestic commerce. In Karachi, the building regulations are restrictive and dissimilar in different parts of the cities, creating problems for new commercial enterprises. Commercialisation of residential property in Karachi is difficult. To convert a residential plot into commercial, fee ranging from PKR 750 to PKR 8,000 per sq. yard has to be paid depending on the location of the building. For buildings in the cooperative housing schemes, an additional amount of Rs 1,000 per sq. yard along with a Ministry of Housing charge of Rs. 400 per sq. yard need to be paid. Violation of the bye-laws results in a penalty of 5 per cent of the commercialisation fees and a further 10 per cent for each year the violation is not corrected. Commercialisation process is also cumbersome laden with paperwork and red tape. Applications have to be filed for change of land use to Master Planning Department of the City District Government Karachi and the Office of the Nazim of the Union Council, along with a newspaper advertisement for comments from the public. The Union Council can take 30 days to accept or reject the application and if there is a clash of decision between the Master Planning Office and the Union Council, the decision is taken by the district assembly. Commercialisation has also been restricted to ‘strip development’ along the 17 major roads of the city rather than having business and commercial districts within the city. This leads to poor usage of space and shows lack of coordination among the different agencies when it comes to city development.

High rise buildings are discouraged in Karachi by enforcing a floor to plot area ratio of 1:3.5 to 5, which results in four-storey buildings being termed as high rises. Parking requirements are stringent with one parking space required of every 100 sq ft. in places of public assembly, 800 sq ft. of floor area for retail shopping, 1000 sq. ft. of business office space and 1200 sq. ft for residential apartment buildings. Private sector activity faces additional regulations in the form of high and multiple taxes (e.g. 2 per cent cost of surety/performance bond has to be deposited with the KBCA in cash) along with facing increasing procedures and corruption. Date of completion regulations are also restrictive with 2 per cent of the value of the project subjected to deductions in proportion to the period of delay, if the delay is not approved by the Authority. Similarly, rented-out properties are required to pay twice the property tax of similar owner-occupied properties as well as high rate of stamp duty and registration fee on the registration of lease documents. Increased building regulations can increase costs and hassles for new businesses to carry out construction in different areas of Karachi. As such, high levels of government intervention can stifle income and economic growth of the city by discouraging new investments.

Source: Shahid Kardar (2010), paper submitted for consideration of Task Force on Urbanisation, Planning Commission

Inadequate Transport and Storage Facilities
Transport and storage facilities are essential for a well-functioning domestic market and for making an impact on the international market through foreign trade and commerce. Storage and packaging of agricultural produce is especially important for Pakistan and there is an urgent need for adherence to internationally certified standards. Freight transport in Pakistan is primarily catered through the road network, with rail handling only 4 per cent of domestic cargo (a decline from 14 per cent in 1990)\(^23\). Even then, Pakistan's trucking fleet is aging, truck sizes are small and cargo facilities do not meet internationally certified standards. Overall, transport efficiency is very low. While the government has deregulated the trucking industry to a certain extent, the rail remains heavily regulated. Declaring the trucking sector an 'industry' in 2005 was also a welcome move by the government.

Storage may be divided into two main categories: storage for agricultural produce (for distribution to markets) and storage for manufactured goods (for distribution to retailers).\(^24\) Agriculture storage includes storage for grains as well as storage for fruits and vegetables, which are highly perishable. Storage and transport of perishable goods requires temperature-controlled environments as well as adequate packaging that protects the quality and maintains the nutritional value of the produce. While cold storage facilities are part of a larger chain of logistics in developing countries, in Pakistan, it is often an isolated sector. Cold storage facilities are usually godown-type facilities which can accommodate 30,000 to 100,000 crates of produce.

There is no zoning for warehousing and distribution, and Pakistan has few facilities with very little spaces for modern and up-to-date storage facilities. Grain storage is primarily in the public sector and is the responsibility of PASSCO (Pakistan Agricultural Storage and Services Corporation)\(^25\), but the current storage facilities are not adequate both in terms of quantity and quality. The storage is very basic and ranges from storage in a heap within the home compound to storage in specially constructed mud bins or bags.\(^26\) The Sindh Provincial Food Department achieved the target of 1.5 million tons of wheat (15 million wheat bags) during the 2009 procurement drive, but only 7 million bags could be stored in the government and privately-rented warehouses. The rest of the bags were left lying in the open.\(^27\)

Inadequate cold chain storage and refrigerated vehicles is a serious problem and has lead to considerable wastage of perishable goods including vegetable and fruit wholesale, and retail markets. According to an estimate\(^28\), about 30-40 per cent of the produce is wasted during transportation between the farm, wholesale and retail markets. In addition to poor farm-to-market roads and lack of refrigerated transport and warehousing, low quality packaging materials and faulty methods of loading and unloading also contribute to wastage of perishable goods.\(^29\) Pakistan’s exports, particularly agricultural products, greatly suffer due to non improvised temperatures in worn out storage centres and cargo transportation. This in turn reduces the shelf life of agricultural produce and makes them less competitive in international markets.

Low Levels of Business Sophistication

\(^{24}\) ‘Storage’, Study for the Ministry of Pakistan, Innovative Development Strategies, 2006
\(^{25}\) PASSCO is a department of the Ministry of Food, Agriculture and Livestock
\(^{26}\) Storage’, Study for the Ministry of Pakistan, Innovative Development Strategies, 2006
\(^{28}\) ‘Improving the Performance of Housing, Tourism and Retail Sectors’, Foreign Investment Advisory Services, Pakistan, 2005
\(^{29}\) ‘Wholesale Markets’, Study for the Ministry of Pakistan, Innovative Development Strategies, 2006
The lack of research and development (R&D) facilities and the lack of market information data are some of the key difficulties faced by small and new businesses which impede their growth. According to a survey of establishments including grocery stores, clothing stores, bookshops, medical stores as well as stores dealing with jewellery, computer hardware and software, fruits and vegetables, bakeries etc., the following results were found regarding business-related services:

- 95 per cent had never used management consultants
- 76 per cent had never used marketing services
- 91 per cent had never used accounting services
- 91 per cent had never used legal or IT services

These results can partly be explained by the finding that retailers, even in urban centres, tend to restrict their businesses to their home city and seldom venture out to other cities. Around 92 per cent of the establishments surveyed were sole proprietorships. In terms of regional expansion, the survey found the following results:

<table>
<thead>
<tr>
<th>Do you wish to expand your establishment?</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes, to same city</td>
<td>381</td>
<td>38.1</td>
</tr>
<tr>
<td>Yes, to other city</td>
<td>83</td>
<td>8.3</td>
</tr>
<tr>
<td>Yes, overseas</td>
<td>5</td>
<td>0.5</td>
</tr>
<tr>
<td>No</td>
<td>531</td>
<td>53.1</td>
</tr>
<tr>
<td>Total</td>
<td>1000</td>
<td>100.0</td>
</tr>
</tbody>
</table>


The majority of respondents (53 per cent had not considered opening another outlet. 38 per cent had considered opening another outlet in the same city, about 8 per cent had considered expanding beyond their home city while only 0.5 per cent had thought about expanding overseas. The key reasons for not expanding their businesses included lack of ability to assess market demand as well as lack of a reliable network of partners in other regions. While Pakistan ranks well in ‘access to finance’ indicators (see Table 5), financing was also quoted as one of the key constraints to expanding business. This may be due to a lack of awareness of financing facilities and opportunities in the financial sector. Religious reasons were also quoted to explain the reluctance to apply for loans and credit.

<table>
<thead>
<tr>
<th>Table 6: Financial Market Sophistication</th>
</tr>
</thead>
</table>

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30 ‘Study on the state of domestic commerce in Pakistan’, Innovative Development Strategies, 2006
31 The lack of use of marketing services is also noticeable in case of warehousing activity. The website of ‘Orient Advertising’, the largest advertising agency of Pakistan, reveals that there is not a single warehousing company on their client list.
32 Interest bearing transactions are prohibited in Islam.
33 Ranking out of 139 countries – lower number implies better ranking.
### Countries Ease of Access to Loans Venture Capital Availability

<table>
<thead>
<tr>
<th>Countries</th>
<th>Ease of Access to Loans</th>
<th>Venture Capital Availability</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pakistan</td>
<td>40</td>
<td>51</td>
</tr>
<tr>
<td>India</td>
<td>39</td>
<td>31</td>
</tr>
<tr>
<td>Indonesia</td>
<td>14</td>
<td>9</td>
</tr>
<tr>
<td>Thailand</td>
<td>31</td>
<td>44</td>
</tr>
<tr>
<td>Malaysia</td>
<td>10</td>
<td>8</td>
</tr>
<tr>
<td>China</td>
<td>51</td>
<td>27</td>
</tr>
</tbody>
</table>

Source: Global Competitiveness Report 2010-2011, World Economic Forum

Legislation barriers and limitations

Pakistan ranks 85th out of 183 economies in starting and running a business. With weak property rights, corruption and inherent inefficiencies in the legal system, Pakistan has failed to strengthen its domestic commerce or make a strong impact in foreign markets. While poor law and order situation along with the energy crisis and political instability pose major hurdles for markets and businesses in the country, additional issues such as lengthy procedures for starting or registering a business, heavy taxes and barriers to international trade make it difficult for businesses to enter the market or operate legally. These hurdles have been identified as one of the major reasons why Pakistan has a large informal sector employing about 73 per cent of non-agriculture labour force.

![Figure 3: The Most Problematic Factors for Doing Business](source: Global Competitiveness Report 2010-2011, World Economic Forum)

Contract enforcement is very weak and hinders supply chain development and delegation to middle management. Property rights (including intellectual property) are also very weak. The table below

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35 Economic Survey of Pakistan 2009-10, Ministry of Finance, Government of Pakistan. Several studies reveal that Pakistan has made significant gains through liberalizing its trade and simplifying trade procedures (Ahmed & O’ Donoghue 2010).
36 From a list of 15 factors, respondents were asked to select the five most problematic issues for doing business in their country and to rank them between 1 (most problematic) and 5 (least problematic). The bars in the figure show the responses weighted according to their rankings.
shows that Pakistan ranks 107th out of 139 countries in terms of property rights protection and 86th in terms of intellectual property rights protection.

### Table 7: Property Rights Protection

<table>
<thead>
<tr>
<th>Countries</th>
<th>Property Rights</th>
<th>Intellectual Property Protection</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pakistan</td>
<td>107</td>
<td>86</td>
</tr>
<tr>
<td>India</td>
<td>61</td>
<td>66</td>
</tr>
<tr>
<td>Indonesia</td>
<td>84</td>
<td>58</td>
</tr>
<tr>
<td>Thailand</td>
<td>89</td>
<td>84</td>
</tr>
<tr>
<td>Malaysia</td>
<td>41</td>
<td>33</td>
</tr>
<tr>
<td>China</td>
<td>38</td>
<td>49</td>
</tr>
</tbody>
</table>

Source: Global Competitiveness Report 2010-11, World Economic Forum

In addition, acquisition and consolidation of land is difficult, uncertain and time consuming. Commercial development is further discouraged by taxes like stamp duties, property tax and outdated rental laws (PIDE, 2006). While the past government supported industry by setting up industrial parks such as Gadoon Amazai and Hattar, there are no commercial or retail parks. Commercial and retail parks are areas where new products could be displayed and marketed, the ‘Software Technology Park’ in Islamabad, for example, was a step in the right direction.

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Some Cross Country and Local Examples

37 Ranking out of 139 countries – lower number implies better ranking
Facilitating the Poor Entrepreneur

*Khokhas* and *rehri-walas* are part of the expanding informal retail sector in Pakistan and can be seen operating in every city. However, throughout Pakistan’s history, the small entrepreneur has been given no opportunity or environment to flourish. Temporary stalls are set up on road sides, street corners and in the corridors of shopping areas only to be pushed out by the authorities. In several East Asian countries including Malaysia, Thailand, Hong Kong and Singapore, spaces are allocated for temporary stalls to be set up resulting in the now famous night markets. These vibrant markets are one of the biggest tourist attractions in their cities. By providing this space, poor entrepreneurs, young students with small businesses, craftsmen and artists, are all provided the opportunity to sell their items without the threat of expulsion.

Brands and Innovation

Enabling and encouraging environment for domestic commerce can be accredited to allowing brands to develop like the well-known international brands that are recognised all over the world. Coca Cola, McDonald’s, Sony, Toyota, Honda, Nike and Nestle are some of the most recognisable brands today. Although Pakistan has some famous brands, they have been unable to make a mark in the international market. Electronic brands such as Waves, Dawlance; apparel brands like Chen One, Bareeze, Gul Ahmed; and restaurants like BBQ Tonight, are all well-known in Pakistan. There is a need to determine why these locally successful brands have been unable to become well-recognised brands globally.

Success stories of international brands and the innovative individuals behind them show that many have started off from humble beginnings. The opportunities they were able to avail in the domestic markets allowed them to expand, flourish and succeed in other regions of their home countries. McDonalds, for example, started off in Chicago, expanded its presence to the rest of Illinois and then to the rest of the United States. After establishing a strong footing in multiple regional and national domestic markets, it was able to expand globally, and today McDonald restaurants are operating in 119 countries and are still growing and expanding.

Within Pakistan, a local success story is that of Nirala Sweets. It started as a *Halwa Puri* (breakfast) shop in 1948 with a capital of just PKR 200 by two individuals. Today, Nirala makes dairy products in addition to sweets and runs a restaurant employing more than 650 people. It has 35 branches in Pakistan and currently exports to Sharjah, Dubai, Canada, Europe and US. Other examples of successful Pakistani restaurants are BBQ Tonight and Student Biryani. Both are domestic businesses. BBQ Tonight started as a small restaurant in Karachi in 1988. Today, 22 years later, it is one of the biggest and most successful restaurants in Pakistan with branches in Karachi, Islamabad, Lahore and plans to expand to Sialkot and other cities.

Desired Reforms for Domestic commerce

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39 Ibid.
40 Note by CEO Nirala sweets at Domestic Commerce Conference, 2006
41 ‘Story of Success with Nanji’, Television Interview of BBQ Tonight Owner 2008
Urban Management and Land Use Reforms

Current zoning laws require a complete overhaul if land market is to respond to goods market demands. There should be no restrictions on the area demarcated for commercial activity in any scheme. Instead, the development of sites and services schemes should be market-driven. The current city planning mindset favours single-family homes for the rich over commercial development and middle class and poor housing. This mindset must be changed so that cities can function as engines of growth and domestic commerce can thrive without being penalised. Urban management should be reformed so that it encourages the development of mixed-use areas, city centres and commercial development. Government land in prime city centre areas should be privatised and those large tracts should be made available for mega commercial projects such as hotels, malls, residential apartments, office buildings and other large projects.

High-rise buildings and high-density mixed-use areas are essential for promoting commerce, employment and development of new businesses. New entrepreneurs with fresh ideas find it difficult to set up their businesses not only because of cumbersome legal procedures but also because of lack of available space. The scope of horizontal expansion is limited and vertical expansion needs to be promoted. For the poor entrepreneur, as mentioned earlier, retail parks and bazaars need to be set up. This has been done in East Asian countries as well as African countries such as Kenya and also could be replicated in Pakistan through guidelines provided to the municipality from the national level after obtaining the Cabinet’s approval. Bazaars not only provide new opportunities and space to set up business for entrepreneurs, they also promote local arts and crafts and attract tourists, which generates valuable foreign exchange for the economy.

Figure 4 presents a model that shows excess demand for hotels, restaurants, office and retail spaces being fulfilled through developing high-density, mixed-use city centres thus promoting domestic commerce and generating employment in both the short-term and the long-term. Similarly, for poor entrepreneurs, setting guidelines for municipalities to provide space for retail parks and bazaars would provide much needed opportunities to poor retailers as well as young entrepreneurs.

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Figure 4: Domestic Commerce Model

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Excess Office Space 
Demand

Excess Retail Space 
Demand

No Space for poor 
entrepreneurs

Develop City Centers

Set up Retail Parks and 
Bazaars

• Construction boom: employment generation  
• Realtors, contractors, lawyers, technicians, architects, construction workers  

• Excess office/retail demand fulfilled  
• Employment generation once the city centre is developed and businesses crop up

Short Term

Long Term

Improving transport efficiency and storage facilities

Improvement of freight transport efficiency should be made a priority considering its role in linking up the entire supply chain network. Competition in this sector is essential. The Government has realised this need and plans to take the required steps through the National Trade Corridor Improvement Program (NTCIP). The NTCIP was launched in August 2005 to revamp the transport infrastructure trade logistics and services as well as to improve regional connectivity.43

Private storage activity needs to be encouraged and space needs to be made available for warehouses. The current facilities are in need of an upgrade. Moreover, good storage facilities would provide much needed hedging opportunities to farmers and producers and facilitate the development of forward and futures contracts with banks and open exchange markets44. The government announced a number of measures to promote cold storage facilities in the private sector to be implemented through the Pakistan Horticulture Development and Export Board (PHDEB).45

Farmers need to be trained in packaging the agricultural produce and loading/unloading in order to minimise damage to perishable goods. For this purpose, the government can set up training centres in collaboration with universities specialising in agricultural studies. The government-university-farmer nexus could prove to be an important initiative in strengthening the agricultural sector and introducing professionalism in the practical areas of work.

Promote Trade Openness and Competition

43 Through this program, several Tasks Force Committees have been set up, including for Trucking Sector Modernisation, Cold Chain Services and Trade Facilitation
44 NU Haque, 'Awake the sleeper within: releasing the energy of stifled domestic commerce', PIDE Working Paper No.11, Pakistan Institute of Development Economics, 2006
45 'Storage', Study for the Ministry of Pakistan, Innovative Development Strategies, 2006
Competition in value chain development\textsuperscript{46} needs to be promoted for a more vibrant domestic commerce sector in Pakistan. This entails free entry and exit of participants in the market (without special privileges or licenses) as well as liberalising policy allowing for mobility with greater fairness and competition for wholesalers to encourage private investment.

The Competition Commission of Pakistan (CCP) has proved successful in the past few years dealing with non-competitive activities of businesses such as the sugar mills, textile industry, telecommunication providers, banks and educational institutes. The CCP and the Competition Ordinance 2007 are meant to guarantee the protection of competition but not of competitors. They are also meant to facilitate business through a coordinated and consultative approach without imposing unnecessary regulatory compliances on businesses. The law also hinders vertical and horizontal agreements that can result in exertion of monopoly power, such as fixing purchase or selling prices, limiting production, markets and investment, applying different and unfavourable conditions to similar transactions across trading parties. Abuse of dominant power is also restricted, such as preventing entry of other firms in the market, refusing to deal, dealing exclusively, etc. Companies are also monitored for unfair trading practices (false or misleading advertisements, offending other competitors, etc.), and mergers and acquisitions are also supervised.\textsuperscript{47}

**Secure Legal Rights and Regulatory Environment**

Secure and transparent property rights, and intellectual property protection (especially for brand names) are need of the hour. Global best practices highlight their role in promoting innovation-led productivity. Taxes, legislation and regulations should not penalise commercial development as they do currently. Clarity in zoning and building regulations needs to be provided to allow for more and larger warehouses and cold chain services.

Due to the difficulties faced in setting up a business, including long delays in obtaining permits and licenses, Pakistan has a large informal services sector. The next section looks at the legal hassles that a business is put through by comparing 13 Pakistani cities in the ease of doing business. The indicators include:

1. Initial set up of a business
2. Dealing with construction permits
3. Registration of property
4. Taxation
5. Enforcing of contracts
6. Time taken to import and export

\textsuperscript{46} Value chain (also known as supply chain) includes the various processes that are involved in producing goods (and services), starting with raw materials and ending with the delivered product

\textsuperscript{47} Competition Commission of Pakistan website: <www.cc.gov.pk>
Key Issues in Manufacturing and Industries

Manufacturing is one of the most important sectors in Pakistan contributing 18.5 per cent of the GDP and 13 per cent of total employment\(^\text{48}\). Large scale manufacturing (LSM), which includes major industries like textile, fertiliser, cement, automobile, etc. holds the largest share of GDP (12.2 per cent), while holding 66 per cent of the sectoral share.

![Figure 5: Manufacturing Share in GDP, Employment and Investment](image)

While 2008 was a rough year for industries and the economy in general, 2009-10 saw a rebound in large scale manufacturing. However, many different industries within the LSM continue to face several problems of which the most prominent one is the energy crisis—denying natural gas and electricity to many sectors. Another major cross-cutting problem is the inconsistency or instability of government policy which creates more problems for manufacturers in the long run rather than solves them. The profiles of three major industries of Pakistan are given below: fertiliser industry is connected to the

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\(^\text{48}\) Pakistan’s Economic Survey 2009-10, Ministry of Finance
agriculture sector which is still one of the biggest employers today; the textile industry boasts of the highest exports; and, the automobile industry is the fastest growing.

**Fertiliser Industry**

Fertiliser industry is one of the main contributors to the growth of large scale manufacturing in Pakistan registering a 10.88 per cent growth in 2009-10 and a percentage point contribution of 0.37 to the growth of large scale manufacturing. Fertiliser is mostly used in the wheat and cotton crop and as such, is essential to Pakistan’s exports and local consumption. The fertiliser industry in Pakistan is dominated by 4 major companies: Fauji Fertiliser Company (FFC); Engro Chemical Pakistan Limited (ECPL); Fauji Fertiliser Bin Qasim (FFBL); and, Dawood Hercules Chemical Ltd (DHCL). FFC is the largest fertiliser company in the country and the largest producer of urea in Pakistan with a capacity of 1.9 million tonnes. It holds 44 per cent of the market share. Engro Pakistan is the second largest with a market share of 21 per cent and currently 41 per cent of its shares are owned by the Dawood Group. FFBL is the only DAP producer in the country and holds 44 per cent of the DAP marketing share. FF owns 55 per cent of FFBL and 17 per cent is held by FF. DHCL holds 8.2 per cent of the market share and is primarily owned by Dawood Group that also holds majority shares in Engro.

Pakistan suffers from an excess demand of urea and DAP. While local manufacturers are able to cater to most of the demand, Pakistan also imports urea (on average 4 per cent). In addition, Pakistan also imports phosphate as a raw material for DAP production. While FFBL conducted a backwards merger with Morocco to cater to its phosphate demand, Pakistan still has to import 70 per cent of its total DAP need. Engro Pakistan plans to expand its urea production to 1.3 million tonnes which will lead to excess supply of urea in Pakistan and is expected to contribute to the exchequer through exports. Certain problems presented by the current situation of the fertiliser industry are discussed below:

**Competition**

The fertiliser industry seems oligopolistic in nature with the market dynamics being controlled by the top four firms that control 86 per cent of the off-take. As such, market dynamics are controlled by these firms which can lead to uncompetitive practices, such as hoarding, monopoly pricing, price discrimination, etc. This also increases the barriers to entry for other firms trying to enter the market.

**Government Intervention and Infrastructure**

While the fertiliser production is dominated by the private manufacturers, fertiliser marketing has a public sector component to it. National Fertiliser Marketing Ltd. (a subsidiary of NFC) is a public sector company that handles the entire domestic production of NFC. However, since NFC is being divested, NFML handles distribution of urea imported by the Trading Corporation of Pakistan. Therefore, NFC and NFML only control 2.5 per cent of the market share with the rest being catered by the private sector. However, even in the private sector the control is in the hands of FFC and ECPL which control 70 per cent of the share.

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49 Di-Ammonium Phosphate
50 ‘Competitive Assessment Study of the Fertiliser Sector in Pakistan’, Competition Commission of Pakistan, 2010
51 Ibid.
52 Ibid.
In 1986, the government took steps to deregulate the fertiliser production and removed subsidies between 1986–1997. Provincial quotas were abolished and import controls were lifted. The subsidies were reinstated between 2004 and 2007 after the rise in international price of urea. These fertiliser subsidies (PKR 29 billion per annum) were given in the form of provision of natural gas at consumer rates to the fertiliser companies in order to lower the price of the agricultural input to farmers. However, these subsidies did not guarantee lowering of retail prices in the face of an oligopolistic market and were not effective. While the government has developed an initiative through the Fertiliser Policy 2001 to attract new investment in the sector, subsidies to the companies and fixing gas prices of 10 years for new investment, can have a severe adverse impact to the economy in the future.

The provision of natural gas to the fertiliser sector at lower rates has led to fast depletion of natural gas resources. As such, even the fertiliser sector is suffering from slow production due to frequent gas supply interruptions in form of load shedding. 20 per cent of gas supply has been cut since May 2010 and winter gas load shedding is scheduled for 45 days in 2010-11. In December 2010, Fauji Fertiliser Bin Qasim shut down its urea production plant while cutting the DAP production by half due to gas shortage. The government is importing more than 0.2 million tonnes of urea to deal with the shortage. Engro raised its prices in December by PKR 190 per bag citing gas shortages as the reason.

The following are some recommendations to overcome the identified problems:

- Amending the Fertiliser Policy 2001 to change the nature of the fertiliser subsidy; instead of subsidizing the companies, the subsidy should be given in a manner to effectively benefit the small farmer
- Improvement in infrastructure to guarantee uninterrupted natural gas supply to the industry and consumers
- Divesting NFML to remove government intervention completely from fertiliser marketing
- Instituting effective monitoring by the Competition Commission of Pakistan to reduce chances of collusion or hoarding in the market

Textile industry

Textile is the largest component of large scale manufacturing in Pakistan (carrying the highest weight of 26.4 in Large Scale Manufacturing growth). Pakistan is the 4th largest producer and 3rd largest consumer of cotton. Textile counts roughly 8 per cent towards the GDP of Pakistan and has a 53.3 per cent share in the exports. Over the past few years, textile industry in Pakistan has seen ups and downs: growing in the period between 2005 and 2007, but declining in 2008 due to the global financial and economic downturn. In 2009-10, the textile and apparel industry suffered a negative 1.78 per cent growth (compared to a negative 0.7 per cent growth in 2008-09), which translated into a -0.47 per cent point contribution to the growth of the large scale manufacturing sector. Even in exports, the textile sector has seen a decline in growth.

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53 ‘Fertiliser Use by Crop in Pakistan’, Food and Agriculture Organisation, 2004
55 S Chaudhry, ‘Economy under stress, says SBP governor’, The Daily Times. 5 January 2011
56 KB Khan, ‘Engro’s New Urea Plant Starts Trial Production’, The News Intemotional. 30 December, 2010
The government has realised the importance of textile in the Pakistani economy and is taking steps to address the falling percentage of Pakistan’s textile and clothing in the world trade. In 2008, Pakistani textiles and clothing accounted for only 1.81 per cent of the world trade, compared to 1.91 per cent in 2007. The Strategic Trade Policy Framework 2009-12 gives several measures to improve the quality of the products and to give support in times of global economic recession. The measures introduced include: promotion of new investment and modernisation of machinery; withdrawal of customs duty on chemicals; establishment of warehouses in major markets; brand development programs; rationalisation of tariffs; initiatives for greater market access and initiatives to promote holding of local and foreign exhibitions.\textsuperscript{58} In addition, Textile Policy was introduced in 2009 and is currently being implemented. It focuses on raising textile exports from USD 17.8 billion to USD 25 billion by 2014. Policy measures addressed include: exemption from load-shedding and prioritised gas allocation; PKR 44 billion provided to value-added textile exports in form of special drawback rates; and allocation of PKR 1 billion for skill development. In December 2010, the Minister for Commerce opposed the duty on yarn export and promised to work with all stakeholders in order to resolve the issues faced by the members of the All Pakistan Textile Mills Association (APTMA).

**Value of Exports**

While textiles and apparel constitute a large portion of Pakistan’s total exports, different sub-sectors have had different export performance over the years. Pakistan has seen a rise in export of raw cotton (117.47 per cent increase in exports and a 141.59 per cent increase in value), cotton yarn (31.75 per cent increase in exports and 28.96 per cent increase in value) and yarn other than cotton (84.92 per cent increase in exports and 102.43 per cent increase in value). These items have lower value added than the other components of the textile industry, such as knitwear (which suffered a negative 8.02 per cent change in exports but only a 1.94 per cent drop in value) or ready-made garments (which experienced a fall of 8.10 per cent in exports, but a rise of 4.10 per cent in value).\textsuperscript{59} The textile industry in Pakistan seems to focus more on exporting ancillary textile rather than on products with higher value addition. These could be due a number of factors, including lack of skill development or depletion or low standard of machines. Since 2004-05, import of textile machinery has been falling rapidly, only rising by 14.2 per cent in 2009-10.

\textsuperscript{58} Strategic Trade Policy Framework, Ministry of Commerce, Government of Pakistan
\textsuperscript{59} Economic Survey of Pakistan 2009-10, Ministry of Finance, Government of Pakistan, 2010
Government Focus

Related to the above problem, is the problem of government focus. The government has failed to provide adequate measures to backup their plans of exporting higher value added products. Even in the Textile Policy (2009-2014), the government does not outline specific plans or measures for sub-sectors but deals with textiles as a whole. Due to the high level of exports, especially of cotton yarn, the local downstream industry has been facing severe shortages, which led to a decline in the export of value-added textile products. In response, the Government placed a quota of 50 million kilogrammes per month on export of cotton yarn in January 2010 but due to lack of implementation, local garment manufacturers had to face rising yarn prices. As such, the quota was reduced in March 2010 to 35 million kilogrammes per month which is said to have been more effective. The quotas, however, are easy to bend since the quota may apply to only one sub-sector, while the exporters can marginally add or reduce value added, making the product fall in a different sub-sector, which is quota free, e.g. if the quota is imposed on cotton yarn, the raw material can be exported in form of raw cotton or a higher spun yarn on which there would be no quotas.

Power

Like all large scale manufacturing industries, textile industry has suffered from uncertainty of gas and electricity supply. In December 2010, the gas supply was suspended for a considerable amount of time, especially for the textile industries located in Punjab. The government has only recently issued a statement that a five-day gas supply will be assured to the textile industry to meet the USD 25 billion export target.

The following are some recommendations to overcome the identified problems:

- Reviewing the Textile Policy 2009-10 and the Strategic Trade Policy Framework 2009-2014 to include strategies for improvement or promotion of different sub-sectors, especially those with higher value added outputs
- Improving the quotas on export of raw materials to take into account all forms of intermediate raw materials in order guarantee a supply of inputs for the local industry and promotion of exports of garments and other higher value-added products
- Infrastructure development and improvement to ensure a consistent supply of electricity and natural gas to the textile industry

Automobile Industry

In 2009-10, automobile industry was the fastest growing large-scale manufacturing industry, registering a growth of 31.58 per cent and 1.25 per cent point contribution to the growth of large scale manufacturing. The automobile sector also employs 192,000 people and contributes around USD 3.6 billion to the GDP of the country.

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60 N Ullah, ‘Resumption of Gas Supply to Punjab Industry Unlikely’, The Express Tribune, 23 December, 2010
63 ‘Analysis of Competition in the Automobile Sector 2010’, Competition Commission of Pakistan, 2010
Table 8: Pakistan Auto Sector Summary (Source: Board of Investment)

<table>
<thead>
<tr>
<th>Type</th>
<th>Number</th>
<th>Capacity in Units</th>
</tr>
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<tbody>
<tr>
<td>Cars</td>
<td>9</td>
<td>275000</td>
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<tr>
<td>Light Commercial Vehicles</td>
<td>11</td>
<td>40000</td>
</tr>
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<td>5000</td>
</tr>
<tr>
<td>Trucks</td>
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<td>26900</td>
</tr>
<tr>
<td>Tractors</td>
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<td>65000</td>
</tr>
<tr>
<td>2&amp;3 Wheelers</td>
<td>43</td>
<td>1600000</td>
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<tr>
<td>Total</td>
<td>82</td>
<td>2011900</td>
</tr>
<tr>
<td>Employment (direct)</td>
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<tr>
<td>Investment</td>
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<td>PKR 98 billion</td>
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<td>Contribution to GDP</td>
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<td>Contribution to Revenue</td>
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<td>PKR 40-50 billion / USD 0.68 billion</td>
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</table>

During the economic downturn of 2008, the automobile industry in Pakistan (with the exception of Farm Tractors) suffered drastically with a negative growth rate of 30.57 per cent.\(^{64}\) In 2009-10, almost all sub-sectors made a recovery with the exception of Light Commercial Vehicles (LCV)/Jeeps which continued to declined. Farm Tractors is the only subsector that has withstood the global financial and economic meltdown, showing positive growth for the past three years.\(^{65}\) However, with rising inflation in Pakistan, a fall in purchasing power is imminent which will adversely affect the growth of passenger cars, buses, etc.

The automobile industry is dominated by three major car manufacturers: Pak Suzuki Motors, Indus Motor Company Limited, and Honda Atlas Limited. Smaller manufacturers include Gandhara Nissan Limited and Dewan Farooque Motors Limited. Despite the recent growth in automobile industry, the industry still faces a few problems.

\(^{64}\) Pakistan Economic Survey 2008-09, Ministry of Finance, Government of Pakistan, 2010

\(^{65}\) Ibid.
Supply and Government Incentives

Pakistani automobiles are only made in 16 plants across the country, which lead to extensive delays for consumers in receiving the cars. The installed capacity for these plants differs greatly from the current production capacity. In 2006-07, Suzuki motors was utilising 31.5 per cent of its installed capacity, while Toyota was utilising 45 per cent, Honda was utilizing 14.2 per cent and Deewan Farooque utilising 2.7 per cent. These gaps in demand and supply are partly driven by government policies, which lowered import duty on CBUs for expensive cars. The custom duty on CBUs are: 50 per cent up to 800 cc, 55 per cent up to 1000 cc; 60 per cent up to 1500 cc, 75 per cent up to 1800cc and 100 per cent on engine displacement exceeding 1800cc. These gaps in demand and supply are partly driven by government policies, which lowered import duty on CBUs for expensive cars. The custom duty on CBUs are: 50 per cent up to 800 cc, 55 per cent up to 1000 cc; 60 per cent up to 1500 cc, 75 per cent up to 1800cc and 100 per cent on engine displacement exceeding 1800cc. This led to most manufacturers focusing on importing high-end CBUs for 1500 cc cars but ignoring the production of passenger cars used by the general public.

Competition

Since most of the market share in the industry is concentrated in the hands of three key manufacturers, lack of competition is a major concern. Evidence of ‘price parallelisms’ with upward trends is noted in the market along with manufacturers charging ‘premiums’ for quicker delivery (which was later termed illegal). Dealers are also thought to be essentially extensions of the manufacturers with the prices being set by the manufacturers, giving no incentive for the dealers to undertake any competitive behaviour. The government has also indulged in protectionism which has decreased competition. The import duty for Original Equipment Manufacturers (OEM) on components not available locally in Pakistan is 32.5 per cent whereas the import duty on components that are also locally-manufactured is 50 per cent to protect the rights of the local manufacturers. The government is also relaxing this duty for new entrants by making all components imported subject to 32.5 per cent duty, as well as allowing them to import completely knocked down (CKD) kits at 5 per cent duty in the first year, 10 per cent in the second year and 20 per cent in the third year, which will tilt the market in favour of new entrants not only initially but also for subsequent years as well.

The following are some recommendations to overcome the identified problems:

- Adopting a consistent import policy and applying appropriate import duties; i.e. there needs to be a clear difference in the import duties of CBUs of 1500 cc cars (more expensive cars) and 800-1000 cc cars (which are demanded by the general public) so as to cater to the growing demand in the middle-income segment
- Monitoring of government policies by the Competition Commission to ensure that they are not creating long-term bias in the market
- Reducing tariffs on new imported cars rather than on import of used cars (since these result in dumping by foreign countries) to create more competition in the market

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66 Ibid.
Key Issues in Agriculture and Rural Markets

The agricultural sector accounts for over 21 per cent of GDP and employs 45 per cent of the country’s total labour force, making it the second largest sector in the economy and the largest employer. Given its share in GDP and employment, ignoring development and management of agricultural and rural markets is not feasible. 62 per cent of the population lives in rural areas, with most incomes connected to agriculture earnings. The four major crops including wheat, rice, cotton and sugarcane on average contribute 33.1 per cent to the value added in overall agriculture and 7.1 per cent to GDP. Facilitation of agricultural and rural markets is essential to the development of Pakistan and growth of GDP.

One of the main problems with the agricultural markets in Pakistan has been the excessive direct intervention by the government leading to constrained productivity and discouraging private sector participation. The government has also intervened through expensive and misdirected subsidies. Another problem is that of low producer prices as well as inadequate research in this sector. Additional issues encountered by rural markets include lack of farm-market links, lack of storage units and law and order problems. Agriculture has continued to play a vital role in Pakistan’s economy but productivity has remained low and growth in this sector has been falling for the past three decades.

In commodity markets, wheat market restrictions remain and are heavily state controlled. Agricultural inputs also continue to be heavily subsidised by the government. There are new challenges of declining water availability as well as climate change. According to the World Bank, the agriculture sector of Pakistan has a strong inequality in the distribution of land and water, with 2 per cent of households controlling more than 45 per cent of the land area. The subsidies in water and agriculture have also been captured by these large farmers. Similarly, in the case of agricultural credit schemes, large farmers have mostly benefited marginalizing majority of the small farmers.

Agricultural growth has been constrained due to inefficient output markets and supply chain systems. The supply chain systems are particularly plagued by rent-seeking with intermediaries capturing most of the value. A liberalised market would be helpful in minimising these constraints to growth.

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68 Ibid.
69 ‘Pakistan: Priorities for Agriculture and Rural Development’, The World Bank, Washington DC
With regards to restructuring state-owned enterprises, Pakistan Agricultural Storage and Services Corporation (PASSCO) continues to operate as before and provincial food directorates have not been restructured either. However, PASSCO and TCP (Trading Corporation of Pakistan) are two of the eight PSEs\(^{70}\) identified by the government for restructuring.

**Agricultural Prices**

Agricultural prices, including both prices of agricultural output as well as inputs for agricultural produce, are an important area that requires policy review. The Agricultural Produce Markets Act of 1939, established during the British rule before the partition is still in effect in Pakistan (albeit with amendments in Punjab and Sindh). This outdated Act does not fully capture the current requirements of the agriculture market as it places control of the agriculture markets in the hand of the government.

Through controlling agricultural marketing, the government tries to protect poor consumers by keeping the prices of agricultural commodities low and within the financial range of the poor. However, most of the items (other than food grains) that reach the market are not essential items for the poor. This price control, in effect, results in a transfer of incomes from the poor farmers to the middle income consumers in the urban areas, and is thus also the reason for the widening income differences between rural and urban areas.\(^{71}\)

The foregoing represents a very small number of obstructions to the growth of productivity in agriculture. Virtually all these would fall under the rubric of ‘governance’, and can be resolved with very little expenditure of financial resources. Modifying or eliminating these impediments would give a substantial boost to growth in the agricultural sector. In removing market restrictions, the Asian Development Bank (ADB) program\(^{72}\) achieved some progress in the removal of price supports and an increase in the prices paid to farmers (close to import or export parity). Some progress was also made in the removal of restrictions on commodity movements.

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\(^{70}\) Public Sector Enterprises

\(^{71}\) SJ Burki, ‘Unconstrained agricultural marketing’, DAWN, Sept 15, 2008

\(^{72}\) ‘Agriculture Sector Program II’, Asian Development Bank, August 2010
Governance for Markets

For markets to function freely and competitively in Pakistan, governance needs to play an important role at the macro level, industry level and at a more micro firm level. While businesses and investments are severely affected by the deteriorating state of security and political instability, they are perceived to be more exogenous and as such difficult to control. To compensate businesses for these, the investment climate has to be made friendlier through reforms aimed directly at the major areas that affect markets and their functioning.

Macro-level Governance

Land Reforms

For businesses to establish, land acquisition is a basic step. In Pakistan, land acquisition is an extremely cumbersome and politicised task. Land titles are not properly established which dilutes property rights making acquisition and transfer of land a lengthy and difficult process. To acquire land, a businessman has to undergo several procedures including going through several real estate agents to find a legally secure land; visiting five different offices to verify if the land title is clear; and, getting multiple permits at different levels of the government to start a business. Land acquisition and transfer, as such, suffer from many problems, such as outdated legal framework, lack of proper records which foster corruption, and inadequate land financing.

In Pakistan, land title regulations are inadequate to cater to the business and investment needs. Under the Transfer of Property Act (1882), the oral transfer of land is permitted in Pakistan. This creates confusion about the ownership of the lands and creates litigations which take years to resolve in the courts. This can scare off potential investors and acts as a big deterrent to the businesses trying to enter the market. The Punjab Pre-Emption Act 1991 also allows pre-emption of neighbours on the land i.e. that the neighbours have the right of first refusal on the sale of agricultural land. While pre-emption is hardly successful in courts, businesses are unwilling to invest in a piece of land where the possibility of pre-emption exists. Benami is still in existence in Pakistan despite several efforts to remove it. Benami is buying a piece of land under someone else’s name to either avoid taxes and creditors. This makes transfer or sale of land a much more difficult process ridden with legal and financial problems, making businesses, especially agricultural businesses, unwilling to enter the market.

Transfer of Property Act 1882 also is unclear on the registration for documents. While Section 54 states that no document creating any interest in land shall have any effect unless registered, Section 54-A of the Transfer of Property Act gives exception for an agreement to sell. An agreement to sell does not confer title but it does give right of specific performance. In short, a buyer under an agreement to sell can file a suit to compel the seller to execute a sale deed with him even though the agreement between the parties is unregistered. Since unregistered documents are relatively easy to forge, agreements to sell are the basis of considerable litigation.\(^{73}\)

Land records are also not kept effectively. There is no centralised record with the government about the land titles often resulting in confusion about who is the actual owner of land. The records by the land revenue department are only evidence of title and do not indicate the actual ownership of the land. Patwari system is used but that is also not conclusive (as it is insufficient and perceptible to corruption) and litigation can ensue because of the confusion of land titles.

\(^{73}\) F Naqvi, ‘Government Regulation and Private Enterprise’,
As such, transfer of land from a private source takes around 64 days because of land titling issues. In the Administrative and Regulatory Cost Survey by FIAS\textsuperscript{74}, 55 per cent of the respondents reported paying bribes. Businesses, especially agricultural businesses, are adversely affected by the difficulties in land transfers and titling. It acts as a strong barrier to entry and as such, leads to a low level of economic activity and investment.

Most land in Pakistan is government owned with private sector being able to lease it for a maximum of 99 years on renewable terms. In addition to this, 40 per cent of all land is under government control. As such, acquiring land from the government is complex and takes around 140 days. In the Administrative and Regulatory Cost Survey by FIAS, 40 per cent of the respondents reported hiring facilitators to help with land acquisition from the government while 53 per cent reported paying bribes. An average of 20 documents were submitted and an average of PKR 5.3 million were spent; PKR 800,000 in non-price fees and PKR 76,000 in bribes.

Strong tenancy laws in the country are an impediment to business activity.\textsuperscript{75} Due to high levels of tenant protection guaranteed under these laws, landlords are unwilling to extend property to businesses on rental basis. As such, if businesses want to enter the market, they have to purchase the property, which is a high cost investment. This prevents many small businesses from entering the markets. The Sindh Rented Premises Ordinance 1970, the Urban Rent Restriction Ordinance 1959 and the Punjab Rented Premises Act 2009 are all biased in favour of the tenant. In Sindh Ordinance, if there is no written contract, the Controller determines the fair rent and the landlord is only permitted to increase the rent of non-residential buildings by 10 per cent per annum over a period of 3 years. Even in the presence of a written contract, the tenant can ask for the intervention of the Controller to determine the fair rent. Under the Rent Restriction Ordinance 1959, if a tax is levied the landlord can apply to the Controller for an increase in rent but he is not permitted to raise the rent by the full amount of tax.

Eviction of tenants is another problem for enforcing tenancy contracts. A landlord who is either a widow, minor orphan or a salaried individual or has reached the age of six years or will retire within the next six months or will become 60 in the next six months can request a tenant to vacate the premises within two months provided he does not rent out the building after retirement or having attained the age of 60. In KPK, if the landlord rents out the repossessed property to anyone other than the evicted tenant, then he/she will be fined. The Controller can also restore the possession of property to the evicted tenant if the landlord does not occupy the premises or puts it for any use other than personal or re-lets it to a third party within one year of re-possession. Also, in Sindh, if the Controller finds the application filed by the landlord of the re-possession of the property to be ‘frivolous’ he can have the landlord pay the tenant a compensation that could be as high as ten months rent. Cases pertaining to rental property make up over 8 per cent of the cases pending under the Supreme Court of Pakistan.

In most countries of the world, mortgage financing plays a big role in financing property for businesses, especially for small businesses. However, in Pakistan, mortgage financing exists at a very low scale. This is partially due to regulation of the State Bank of Pakistan that requires only minimal financial sector training and partially due to the weak land titles and strong tenancy laws. Pakistan has one of the lowest mortgage financing levels among major emerging economies, less than 0.7 per cent of GDP against 9 per cent in India, 35 per cent in Malaysia and over 100 per cent in the UK.\textsuperscript{76} As such, most enterprises have to buy property at the full sale price if they want to undertake business instead of taking out mortgages.

\textsuperscript{74} Review of Administrative Barriers to Investment’, Foreign Investment Advisory Service, May 2005
\textsuperscript{75} S Kardar, ‘Building Regulations’, presented to Planning Commission Task Force on Urbanisation, 2010
\textsuperscript{76} S Raza, ‘Quarterly Housing Finance Review 2008’, State Bank of Pakistan, 2009
While the State Bank of Pakistan has tried to promote mortgage financing for housing, further changes are required in the Banking Policy Department (BPD) circulars to incorporate commercial mortgaging. Financing through land is also limited in Pakistan mainly because of land title issues. While land as a collateral fetches around 90 per cent (or more) of the value of property in many developed countries, Pakistani banks only extend 50 per cent of the property value with land as a collateral.

The following are some recommendations to overcome the identified problems:

- Amendment to the Transfer of Property Act 1882 to disallow transferring property through verbal gifts
- Amendment to the Transfer of Property Act 1882 to make the agreement to sell effective only if it is registered
- Repealing the Punjab Pre-Emption Act 1991, disallowing neighbours to the right of first refusal to a property
- Centralising land title records and consolidating the steps taken when purchasing land (i.e. visiting only one agency instead of SECP, Land Registrar, Revenue Department, Excise Department and Local Development Authority)
- Computerising and clarifying land records, as done in Punjab under the Punjab Land Records and Information Management Systems (LRIMS) project
- Setting up a Multi-Listing Service (MLS) to have a computerised record of available land for sale
- Auctioning off government-held land and transferring government-owned land (on 99 year leases) to full freehold
- Relaxing the tenancy laws and rented premises ordinances and acts, giving more rights to the landlord
- Advising the State Bank of Pakistan (SBP) of possible amendments to the Banking Policy Department (BPD) circulars affecting mortgage financing for businesses and encouraging SBP to enforce the Prudential Regulations by increasing financial sector training requirements on credit risk evaluation

**Tax Reforms**

Doing Business 2011 ranks Pakistan at 145th out of 183 economies, a decline from the previous 139th position. While Pakistan has a total tax rate of 31.6 per cent (of profit), lower than the South Asian average of 39.9 and the OECD country average of 43.0, tax payment in Pakistan is more time consuming (requiring 560 hours per year compared to 282.9 hours average of South Asia and 199.3 hour average of OECD countries) and requires more procedures (47 procedures compared to 31.1 average of South Asia and 14.2 average in OECD countries).
Table 9: Tax Rates for Businesses in Pakistan

<table>
<thead>
<tr>
<th>Tax or mandatory contribution</th>
<th>Payments (number)</th>
<th>Notes on Payments</th>
<th>Time (hours)</th>
<th>Statutory tax rate</th>
<th>Tax base</th>
<th>Total tax rate (% profit)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stamp Duty</td>
<td>1</td>
<td></td>
<td></td>
<td>Slab rate based on contract value</td>
<td></td>
<td></td>
</tr>
<tr>
<td>VAT/GST</td>
<td>12</td>
<td>480</td>
<td>15.0%</td>
<td>Value added</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Vehicle tax</td>
<td>1</td>
<td>Fixed fee</td>
<td>0.2</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax on interest</td>
<td>0</td>
<td>Withheld</td>
<td>10.0%</td>
<td>Interest</td>
<td>0.3</td>
<td></td>
</tr>
<tr>
<td>Professional tax</td>
<td>1</td>
<td>Fixed fee (PKR 10,000)</td>
<td>0.4</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fuel tax</td>
<td>1</td>
<td></td>
<td>25.0%</td>
<td>Value of fuel consumption</td>
<td>0.8</td>
<td></td>
</tr>
<tr>
<td>Property tax</td>
<td>1</td>
<td>18% (including 10% discount)</td>
<td>0.9</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Education cess</td>
<td>1</td>
<td>PKR 100 per month</td>
<td>2.7</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pension contributions</td>
<td>12</td>
<td></td>
<td>5.0%</td>
<td>Gross salaries</td>
<td>5.5</td>
<td></td>
</tr>
<tr>
<td>Social security contributions</td>
<td>12</td>
<td>40</td>
<td>6.0%</td>
<td>Gross salaries</td>
<td>6.8</td>
<td></td>
</tr>
<tr>
<td>Corporate income tax</td>
<td>5</td>
<td>40</td>
<td>35.0%</td>
<td>Taxable profit</td>
<td>14.3</td>
<td></td>
</tr>
<tr>
<td>Totals</td>
<td>47</td>
<td>560</td>
<td></td>
<td></td>
<td>31.9</td>
<td></td>
</tr>
</tbody>
</table>

**Tax Administration and Registration**

The major problem for Pakistan is the tax administration and registration system which takes a high number of days and procedures for filing and processing taxes. Businesses face many different forms of taxes (around 16 principal taxes and 30 minor ones), such as the Workers’ Welfare Fund Tax, Employees Old Age Benefits, Workers Children (Education) Tax, Social Security, Workers Welfare Fund Levy, etc. Registration for taxes is also time consuming and difficult for firms. Registration for GST takes 14 days and requires around 12-15 documents. A total of 52 statements are required each year of every taxpayer while the companies also have on average three tax inspections per year for auditing. Tax compliance costs can be a large part of the businesses’ cost, equivalent to almost 20 per cent of tax paid.

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77 For a review of tax issues in Pakistan see Ahmed and O’Donoghue (2009).
78 ‘Review of Administrative Barriers to Investment’, Foreign Investment Advisory Service, May 2005
High regulations and administrative costs of tax compliance can force many businesses into the informal sector and encourage illegal economic activity in the country. This results in lower productivity and lower economic growth. Taxation in Pakistan is also not considered stable since policies and tax legislations in the Tax Code are changed frequently due to the policy setting discretion given to the Federal Board of Revenue (FBR). The Income Tax Ordinance 2001 and The Sales Tax Act 1990 are laws that mandate heavy regulation and periodic checking and verification of documents, which lead to businesses spending a considerable amount of time and resources handling tax requirements. There are also no provisions in the Income Tax Ordinance (2001) and the Sales Tax Act (1990) for a One-Stop tax filing mechanism at the sub-national level. These legislations also do not cater to ex-post verification of company registration which can prevent delays in the setting up and operation of businesses. As such, due to the high levels of complications involved in tax registration and administration, investment is discouraged.

**Tax Burden**

Under the Income Tax Ordinance 2001, the current corporate tax rate in Pakistan is 35 per cent for public, private and banking firms. Countries, like Bangladesh, India and Singapore have taxes in the 25-30 per cent range, while in some European countries corporate tax rates are lower than 15 per cent. A high corporate tax rate can lower investment and stifle economic activity and growth by acting as a barrier to entry in formal markets.

**Tax Auditing**

Tax auditing in Pakistan is a process that is undertaken too frequently for businesses in Pakistan. A business faces an average of three inspections per year, due to misaligned incentives of the employees in the Federal Board of Revenue (FBR) which lead to rent-seeking. The Income Tax Ordinance 2001 along with the General Sales Tax Act (1990) allows excessive discretionary power to the tax collectors at FBR to police firms and business they suspect of being non-compliant. For businesses, auditing is costly. In the Business Intermediary Survey (BIS), 43 per cent of the firms were reported making informal payments to inspectors during the auditing and inspection process. The average payment was PKR 25,432, while the average fine is PKR 92,354. For larger firms, the payments are around PKR 160,000 per year while these firms spend over PKR 236,000 on tax advice.80

The revenue targets are also not clearly specified which lead to overtaxing of the 'good' taxpayer. Many agencies are involved in tax audits including the Directorate of Revenue Receipts Audit (DRAA) which is under the Auditor General and is not coordinated with the FBR.

**Tax Refunds and Appeals**

For most businesses, taxes present a problem in the form of delays in refunds. GST refunds can take up to six months in Pakistan due to Government cash-flow constraints and lack of updated software. This creates high financial costs for businesses which have to borrow from banks and suffer from severe interest rate fluctuations. Contesting the tax or appealing is itself a lengthy process in Pakistan, taking an average of 5-6 months to resolve. A main reason for this is the lack of capacity of the tax judges along with the lack of consideration in the Income Tax Ordinance (2001) and the Finance Ordinance (2000). Under the Income Tax Ordinance 2001 and the Finance Ordinance 2000, assessment Orders are frequently passed following set-aside decisions of original orders by Tax Courts. Also, under these

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80 'Business Intermediary Survey', Foreign Investment Advisory Service, 2005
legislations, dispute resolution requires payment of 15 per cent of the disputed amount before judicial process commences.

The following are some recommendations to overcome the identified problems:

- Making amendments to the Income Tax Ordinance 2001 and Sales Tax Act 1990 to limit the discretionary power of the Federal Board of Revenue to improve administration, auditing system and tax refunds system
- Rationalising the tax system and limiting direct taxes by businesses to 3-5 taxes
- Simplifying the tax system and tax administration by creating one-window cells for tax registrations at the sub-national level to cater to all taxes (Federal, Provincial and Local)
- Unifying NTN and GST registration to one Tax Registration Number through amendments to the Income Tax Ordinance 2001 and the General Sales Tax Act 1990
- Improving technology and e-governance strategies to facilitate tax registration and tax filing system at the FBR
- Making amendments to the Income Tax Ordinance 2001 to lower corporate tax rates below 35 per cent for private and public businesses
- Reviewing revenue generation targets by providing specifics of type, source, region, etc. so as to limit the burden on the ‘good’ taxpayer
- Modifying the Income Tax Ordinance and the Finance Ordinance (2000) to appropriately deal with time limits for refunds and judges who fail to meet these time limits
- Removing the requirement of 15 per cent of the disputed amount before the adjudication through amendments to the Income Tax Ordinance and the Finance Ordinance (2000)

Labour Reforms

Pakistan is one of the few countries in the world with low per-unit labour costs, especially in sectors such as textiles and food processing. However, for businesses to fully avail these benefits, the legislative framework as well as the implementation of the legislation has to be conducive to productivity rather than restrictive. Pakistan is the 10th largest country in the world according to labour force, which is estimated at 53.73 million. A large portion of the labour force is employed in the informal sector (categorised under own-account workers, unpaid family workers and casual wage workers81) and many industries (over 30 per cent) and manufacturers hire employees on temporary or seasonal basis82. With the new Labour Policy 2002, many firms do not perceive labour regulations as a major hurdle with only 5.9 per cent of the firms citing it as a severe constraint in 2007 as compared to 15.8 per cent in 200283. However, improvements can still be made, especially regarding some restrictive legislation, enforcements of new legislation and improving flexibility of hiring.

Labour Laws and Employee Benefits

Pakistan has many outdated labour laws, some dating from pre-partition time and having no relevance to existing conditions. These include the Labour Law (1882), Factories Act (1934) and Payment of Wages Act (1936). Pakistan’s labour legislation is unconsolidated with over 50 laws dealing with different industries and aspects of labour. Labour laws are also complicated and many steps and departments are involved. For labour registration, 25 documents are needed; 69 days are required and over PKR 45,000

82 Investment Climate Survey 2007
83 Ibid
are spent. Under the labour laws, medium-large size firms are required to provide non-wage benefits to the employees, which include Gratuity or Provident Fund, Provincial Social Security (ESSI), Employment Old Age Benefit (EOBI), group insurance and Worker’s Profit Participation Fund (WPPF). Registration and implementation of these is time consuming and present a sizeable time and monetary cost to the employer. The ESSI is managed at the provincial level while the EOBI is comes under the Federal Government. Two other benefits are the education cess and the ‘10C’ bonus. Firms, qualifying for the provision of these benefits, are required to pay 5 per cent of the payroll tax to EOBI, 7 per cent of the payroll tax to ESSI, 8.3 per cent of the payroll tax to Gratuity and 8.3 per cent to 10C bonus. Firms that are required to have group insurance have to get an insurance of PKR 200,000 per employee. These requirements impose a high fee on the firms and discourage investors from hiring more employees.

The Labour Policy 2002, while consolidating many old laws and regulations, keeps in place many restrictions of firm autonomy and costly requirements for employment. This encourages firms to avoid compliance with these laws, by hiring employees on a short-term basis which affect productivity.

**Implementation of Law**

In most cases, while the laws may not be that restrictive, implementation of the laws is a barrier to firms. Most firms indulge in unofficial payments to the law enforcers to by-pass various regulations. As such, inspections by labour regulators is high in Pakistan where 48 per cent of the firms were inspected in a year of which half were required to make informal payments to the enforcement officers.\(^{84}\) The EOBI has discretionary powers in the registration process which can cause delays for the firms if they are unwilling to extend unofficial payments.

**Inflexibility of Hiring**

Pakistan also suffers from inflexibility of labour hiring. Pakistan is one of lowest ranked countries on the ease of hiring index, despite the Labour Policy 2002 which made the situation slightly more flexible for firms. In 2005, the Difficulty of Hiring Index gave Pakistan a score of 78 whereas the average for South Asia was 37.\(^{85}\) Due to numerous requirements of providing benefits to the formally hired workers, many firms rely on temporary workers. Many firms hire new employees through family and friends with about 79 per cent of the firms in the services sector finding employees through friends and family networks.\(^{86}\) This has been shown to reduce productivity since family/friends are guaranteed job security.

The following are some recommendations to overcome the identified problems:

- Amending the EOBI Act and the ESSI Act to create one Social Security provision institution at the provincial level
- Reducing the number of procedures and time taken to register for labour regulations by amending the EOBI Act, ESSI Act and the Directorate of Labour Welfare Act
- Increasing the number of employees requirement after which the social security provisions are mandated (e.g. from 19 employees to 70 employees)
- Introducing technology and online procedures at the EOBI and ESSI to reduce time and the number of procedures involved

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\(^{84}\) Investment Climate Assessment

\(^{85}\) Doing Business Database 2011, World Bank Group

\(^{86}\) Ibid.
• Amending the Employee Old Age Benefits Institution Act (1976) to reduce the discretionary powers of the EOBI and introducing legislation that clarify the requirements for registration and implementation

• Upgrading and consolidating laws and acts into a fewer pieces of legislation, such as upgrading Companies Profits (Workers Participation) Act (1968), Apprenticeship Ordinance (1962), Workers Children (Education) Ordinance (1972), Workers Welfare Ordinance (1971) and making them into one law as well as instituting checklists at the Directorate of Labour Welfare and the BOI to ensure compliance with laws

• Passing legislation that limits hiring of temporary workers to a certain level in specific industries to increase productivity and guarantee better job security

Legal/Judicial reforms

The legal and judicial system in Pakistan needs major reforms, especially in the context of businesses and markets. Protection of rights and settlement of disputes is a major factor for firms conducting businesses since these can result in high costs and time. In enforcing contracts, Pakistani courts on average require 47 procedures (higher than the South Asian and the OECD countries average) and 976 days (lower than the South Asian average but much higher than the OECD countries average). Of these days, trial and judgment take around 580 days and the enforcement takes another 300 days. These delays and high costs associated with them (23.8 per cent of the claim) discourage investment and establishment of new businesses, especially those that are based on intellectual property rights.

Judicial Administration

In Pakistan, courts are ‘completely inundated with excess litigation, with cases pending for years and years’. The judicial system in Pakistan is generally slow to respond to the filed cases. There are instances where the complainant and the respondent both have long been dead and the courts do not know this because they do not have the resources to deal with the backlog for dead cases. According to the government's Law and Justice Commission of Pakistan (LJCP), more than 1.1 million cases are pending with country’s lower courts as of May 2010 while 150,000 cases await the attention of four provincial high courts. The Supreme Court’s backlog of cases is about 17,50,090.

The reason behind these is the lack of physical facilities for the resolution of disputes, e.g. Karachi still has the same number of courts it did in 1937 when the population was just 200,000. Another reason is the training of the judges: many judges are not qualified to handle the volume of cases that come into the courts, let alone commercial cases. Also, interlocutory injunctions are abused in the Pakistani judicial system with all judges having 40-50 injunctions, causing unnecessary delays and costs to businesses and the public. Corruption in courts is also rampant, with businesses citing ‘necessity to pay bribe’ as the second most prominent reason for not going to courts, aside from the length of the process. The politicising of the judiciary is also a big problem. With multiple martial laws, the Constitution has been suspended many times, the judiciary has been scrutinised and at times many judges have been retired from the Supreme Court and the High Courts. As such, there is a high political involvement in legal matters. Recently, there have been many incidences where lawyers have become violent, physically fighting with the media, the police and even judges. Due to these factors, Pakistan ranks low among

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87 Doing Business database 2011, World Bank Group
88 Ibid
89 Rawalpindi Chamber of Commerce and Industry
90 K Haider, ‘Court Cases Backlog Suffers Common Pakistani’, Reuters, 21 July 2010
South Asian countries in the Rule of Law governance indicator\textsuperscript{91}. The Supreme Judicial Council has never exercised its right in the removal of Superior Court judges even when they have incriminating evidence against them. For example, in 2001, incriminating taped conversations between then-Chief Justice of the Lahore High Court and some key government officials were brought forward but the Supreme Judicial Council did not take notice\textsuperscript{92}.

**Intellectual Property**

Protection of Intellectual Property Rights (IPR) is a problem in Pakistan where 14 per cent of the firms interviewed in the ARCS identified poor IPR being a problem and 37 per cent cited as a severe constraint. IPR issues in Pakistan are especially detrimental to foreign investment. Registering with the Trademarks Registry, the Patents Registrar and the Registrar of Copyrights is time consuming, with the trademark registration taking 37-38 months, patents registration taking 12-36 months and the copyrights registration also taking several months\textsuperscript{93}. With the establishment of the Intellectual Property Organisation (IPO) of Pakistan, along with the Anti-Piracy Ordinance 2002, enforcement of the IPR standards are underway and the situation has improved.

Intellectual Property protection was identified as a major barrier to investment by the Asian Development Bank as well by the US Embassy in Pakistan. United States Trade Representative has put Pakistan on the Special Section 301 Watch List every year since 1989 to 2003 and on the Priority Watch List in 2004 and 2005 for lack of proper protection of IPR. In 2009, Pakistan was again downgraded to the Priority Watch List after been on the Watch List for a few years. Although the IPO in collaboration with FIA, has taken several steps, such as raids on optical disk piracy, book piracy and counterfeit products, but piracy and theft of intellectual property still remains a big obstacle to foreign investment and local businesses. Similarly, Patents (Amendments) Ordinance (2002) does not guarantee protection or special patents to biotechnology or industrial design. This limits biotechnology-based inventions and investments, and affects foreign pharmaceuticals companies adversely.

The following are some recommendations to overcome the identified problems:

- Strengthening Alternative Dispute Resolution (ADR) Mechanisms for resolution of commercial disputes
- Undertaking capacity building of lawyers, judges and administrative officers to adequately handle cases pertaining to commercial or business disputes or intellectual property rights violation and also to deal with backlog of pending cases
- Introducing more judicial infrastructure, such as more courts, in high density areas to handle more cases quickly
- Introducing legislation or amending the existing legislation to separate the judiciary and the Supreme Judicial Council from political influence
- Setting timeframes for resolution of cases, otherwise holding the judges accountable
- Amending the Intellectual Property Organisation Ordinance 2005 to give more discretionary power to the IPO to undertake action against violators of IPR
- Amending the Patents (Amendments) Ordinance 2002 to include biotechnology and industrial design

\textsuperscript{91} World Governance Indicators, World Bank Group
\textsuperscript{93} ‘Review of Administrative Barriers to Investment’, Foreign Investment Advisory Service, May 2005
Industry Level Governance

Industries and Manufacturing

Pakistan’s industry is showing signs of improvement after taking a hit during the global economic downturn of 2008-09. The following reforms are suggested to boost the recovery process that lead to growth not only in the Large Scale Manufacturing and Industry Sector but also in the overall economy.

- Amending the legal framework (Fertiliser Policy 2001, Textile Policy 2009-10 and the Strategic Trade Policy Framework 2009-2014, etc) to change the nature of subsidies and include strategies for improvement and promotion of different sub-sectors, especially those with higher value-added outputs (e.g. in textiles)
- Improving infrastructure to guarantee uninterrupted natural gas and electricity supply to the industries
- Instituting effective monitoring by the Competition Commission of Pakistan to reduce chances of collusion or hoarding in the market
- Adopting a consistent import policy and applying appropriate import duties; i.e. there needs to be a clear difference in the import duties of CBUs of 1500 cc cars (more expensive cars) and 800-1000 cc cars (which are demanded by the general public) so as to cater to the growing demand in the middle-income segment

Agricultural and Rural Markets

The major goal of agricultural reform is to promote efficient functioning of markets to improve both productivity as well as profitability. The role of the government needs to be limited while the role of the private sector needs to be expanded.

Private Sector Involvement

With the agriculture markets being under the government control, they suffer from low development and lack of involvement from small private farmers. The Agriculture Produce Markets Act 1939 affects small farmers more than the big landlords and as such reduces development at the lower-income levels. The Ministry of Food and Agriculture should focus on repealing the Agriculture Produce Markets Act and replacing it with a more updated ordinance that allows small private farmers to sell their produce directly. This will prove beneficial in eradicating poverty in rural areas and developing rural markets.

The Punjab Agricultural Department is in the process of updating its Agricultural Marketing Act and has presented the latest draft of the Punjab Agricultural Produce Marketing Act 2010 to the Chief Minister of Punjab. The act is aimed towards the development and modernisation of agriculture produce marketing and markets in the province. A high-level committee has been set up and is in the process of drafting recommendations.

Better Communication and Transport
Interaction between urban and rural areas will lead to better developed rural markets. Better farm-market roads and telecommunication systems can help promote not only the welfare of the rural population but also tap into rural areas as markets since majority of the Pakistani population resides there. Although many roads link urban and rural areas, better transportation systems could be made available to transport farmers and their produce to urban areas where a larger market for their produce exists. With better transportation, the bazaars for agricultural products held three times a week could be made more frequent. Urban businesses can also look to expand in rural areas if better communication methods are available.

Storage Units

Given the perishable nature of agriculture produce, storage units are essential to help facilitate rural and agriculture markets. Cold storage units can preserve the produce and dispense with the need to have it brought directly from the farms every day. This can expedite the rural to urban movement of agriculture produce, strengthening rural markets. Farmers can also be trained in proper packaging of produce to reduce waste and to prevent damage during transportation.

Deregulate Agricultural Markets

This has been initiated through the ‘Pakistan Mercantile Exchange’ on which, out of the agricultural products, IRRI rice has been listed so far. Sugar is awaiting final approval from SECP, and is expected to start trading very soon. Wheat, maize, Basmati rice and cotton are also expected to start trading soon. This process should be further strengthened and the government must gradually exit from regular commodity operations.

Security

Since rural areas have a more informal judicial setup as well as a more relaxed policing system, most rural businesses face security issues. Stores often face the possibility of being pilfered and/or taken over by powerful locals. Losses due to theft are estimated at around 2 per cent of sales, whereas global figure is closer to 1 per cent.94 As such, to ensure the success of a business, proper policing measures have to be enforced in rural areas.

Trading Processes

International trade is important for a thriving domestic market. Foreign trade brings in competition, improving quality and variety of goods available to consumers. However, to ‘protect’ the local industry, Pakistan at times engages in import substitution policies which increase the duties and regulation on imported items to ensure that domestic industries do not suffer. Clothing, leather items and dairy products all have custom duties ranging 25-35 per cent.95 Although Pakistan has been actively trying to promote exports, there are still many regulations that could be rationalised in order to reduce transaction costs. There are differences between cities in the number of days it takes to import and export. Based on these differences, it is cheaper to trade in some cities compared to others. By adopting the time of the most efficient city, an average Pakistani business can save USD 52.4 on exporting and USD 82.196 on importing. Given the current proposals by the Strategic Trade Policy Framework 2009-12

94 ‘Pakistan: Improving the Performance of Housing, Tourism and Retail Sectors’, Foreign Investment Advisory Service, 2005
95 Federal Board of Revenue, Government of Pakistan
96 This is calculated by looking at the linear relationship between the cost and time taken across cities to find out the impact on the cost of doing business due to a one-day delay
which focus on looking at specific industries and businesses to develop for international trade\textsuperscript{97}, some changes suggested for overall facilitation of importing and exporting are:

\textit{In-land Clearing Facilities}

With only 1046 km of coastline, Pakistan needs to establish dry ports to effectively handle import and export. These dry ports can reduce administrative delays and provide more capacity than otherwise available in inland cities. Sialkot has set up a relatively successful dry port, which can be replicated in other major cities. In September 2010, the Sialkot Dry Port Trust handled 2365 consignments, weighing 5577 tons, worth PKR 4062 million in the export sector. The cargo was transported from the dry port to Lahore, Islamabad, Karachi and Peshawar Airports, KPT and Port Qasim Sea Port\textsuperscript{98}. Ministry of Commerce could encourage more investors and exporters/importers to set up dry ports in other parts of the country to streamline customs and other procedures and make trade quicker.

\textit{Transportation and Communication}

Improved transportation facilities can facilitate import and export processes. In spite of having widespread infrastructure, Pakistan Railways handles an insignificant portion of the total freight because of infrequent and unreliable service. Businesses have to use trucks which are relatively slow as compared to rail. Computerisation of the customs system can facilitate international trade. Strengthening of existing computerised customs clearance system can be done by removing uncertainty and making it compliant with the customs procedures (as in the case of the Pakistan Customs Computerised System in Karachi) to boost international and domestic trade. Ministry of Commerce and the Federal Board of Revenue can work together on fixing the existing setup as well as introducing the system in other parts of the country.

\textit{Firm Level Governance}

Policy makers and government agencies recognise the need for reforms in domestic commerce. The government has already taken a few steps to improve the business environment, raising Pakistan's ranking in Doing Business to the highest in South Asia. Use of technology has been a major innovation in improving business regulations. In 2008, e-Services website was set up by the Securities and Exchange Commission of Pakistan (SECP) and the e-Government Directorate to facilitate registration of companies. Computerisation of land records in Lahore and Sialkot is making it easier for businesses to register. In Sialkot, the time for companies to register was halved from 13 days in 2006 to only 6 days in 2009. Tax administration reforms were also initiated to give businesses more access to tax filing authorities\textsuperscript{99}. Privatisation of Pakistan Telecommunication Company Limited (PTCL) was another major step that reduced costs of getting a new telephone by 64.8 per cent, and the introduction of an advanced electronic data interchange system which made importing and exporting regulations easier. However, there were also some measures enforced that adversely affected businesses. The Finance Law (2009) raised the capital value tax from 2 per cent to 4 per cent. This translated into an increase of 3.6 per cent in cost of property value for businesses.

\textsuperscript{97} Ministry of Commerce, Government of Pakistan
\textsuperscript{98} Sialkot Dry Port Trust, September 2010 Press Release
\textsuperscript{99} The Government has set up 3 taxpayer units and 16 regional tax offices in large cities, along with a Universal Self-Assessment Scheme to aid businesses in filing taxes and reducing processing time
Despite these initiatives, Pakistan still needs to take major steps to improve the functioning of its internal markets. Given the high levels of corruption and a poor law and order situation, many more reforms are needed to compensate businesses for these destructive elements. These reforms can remove inefficiencies from the markets as well as provide support to the businesses to allow them to function freely and cost-effectively. While establishment and functioning of new businesses is essential, improvements also need to be made in connecting rural and urban markets, and improving temporary storage and long-term warehousing facilities, especially for agricultural (perishable) goods.

As mentioned in the report on Doing Business in Pakistan 2010, to improve business and domestic commerce, Pakistan needs to initiate and implement reforms in the areas discussed below.

**Initial setup of business**

Pakistan stands well when compared internationally to other countries in the amount of time it takes to set up a business. Business in Pakistan takes 21 days on average compared to 28 days average of South Asia, 30 days in India and 37 days in China. This is mainly due to the e-Services system, which has helped businesses immensely in setting up in Islamabad, Faisalabad, Lahore, Karachi and Peshawar. Furthermore, in Punjab, Punjab Employees Social Security Institution was transferred from provincial to local governments speeding up social security registration processes in Lahore and Faisalabad. Islamabad proved to be the best place for initial setting up of business, with the least number of days required and ranked 1 by the Doing Business in Pakistan 2010 report. If other cities could reduce their days in setting up a business to Islamabad’s level i.e. 16 days, the average saving to a business would be USD 73.3, since a reduction of one day would lead to a subsequent reduction in cost by 1.51 per cent of GNI per capita.

Construction permits show similar results. While construction permits are issued relatively quickly in Pakistan, the associated costs are high to businesses. As such, reduction in number of procedures and in the number of days can reduce costs for businesses. A reduction of one procedure in issuing permits (holding number of days fixed) is 3.23 per cent of GNI per capita and a reduction of one day in issuing permits (holding number of procedures fixed) is 2.1 per cent of GNI per capita. Multan is one city that requires the least number of procedures to get a construction permit, while Peshawar takes the least number of days. If the practices of these cities were used in other cities, an average cost saving of USD 48.8 can be realised from adopting less procedures (as in Multan), and a saving of USD 845.4 from using fewer days (as in Peshawar).

Registering property in Pakistan is outdated and cumbersome. Land records are mostly paper-based. Computerisation of land records has taken place in Sialkot and Lahore, in which the time taken to register is much less than other places in Pakistan. A reduction of one day in registration results in saving in cost of 0.11 per cent of property value which can translate into a cost saving of USD 612.85 for an average business in Pakistan. If the best practices across all these three stages were adopted, an average of USD 1580 could be easily saved by an average business, as shown in the table below.

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100 World Bank, International Finance Corporation, USAID, UKAID

101 This is calculated by looking at the linear relationship between the cost and time taken across cities to find out how much a change one day can affect the cost of a business
Table 10: Summary table of average amount saved by a business

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Avg. Amount saved (US $)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Starting a business</td>
<td>73.28</td>
</tr>
<tr>
<td>Dealing with construction permits</td>
<td>48.84</td>
</tr>
<tr>
<td>(better procedures)</td>
<td></td>
</tr>
<tr>
<td>Dealing with construction permits</td>
<td>845.43</td>
</tr>
<tr>
<td>(better time)</td>
<td></td>
</tr>
<tr>
<td>Registration of property</td>
<td>612.85</td>
</tr>
<tr>
<td>Total</td>
<td>1,580.39</td>
</tr>
</tbody>
</table>

Source: Calculations using data from Doing Business in Pakistan 2010

To bring about the changes that could result in such savings, following are suggested reforms:

**Using Technology**

More cities should be encouraged to adopt technological tools, such as e-Services. These can drastically reduce the number of days and the costs associated with starting and running a business. For those regions where internet services are difficult to access, the registration offices should have kiosks to facilitate the online registration process. This will not only speed up the process, but will minimise chances of corruption due to lack of personal interaction. While use of technology (e-Services) has been started by Securities and Exchange Commission (SECP) and the e-Government Directorate, further collaboration with Ministry of Communication and the Pakistan Telecommunications Authority (PTA) is required to make the use of technology more widespread for setting up businesses.

**Merging and Reducing Procedures**

In Pakistani cities currently, five offices have to be visited before one can start up a business. Consolidation of the procedures under either the local registrar or the Chamber of Commerce can help reduce time and hassle for businesses, making passage into the markets easier. In Jordan and Egypt, tax registration was given to the registrars, which considerably reduced time for businesses. Collaboration between the Ministry of Commerce and the local governments would help facilitate the operation of one-window cells to speed up establishment of business.

**Better Construction and Planning Regulations**

In Pakistan, cities in Punjab have adopted uniform zoning and building regulations, which have lessened the time taken by businesses in cities like Lahore and Sialkot to obtain a construction permit. Absence of such regulations in other provinces and cities, such as Quetta, has in some cases increased the time for obtaining a permit. Zoning laws can be improved through actions by the local city development agencies, such as the Capital Development Authority (Islamabad), Lahore Development Authority, Karachi Building Control Authority (KBCA) and the City District Government Karachi (CDGK), etc.
Tailoring Procedures for the Business

Different types of businesses require different procedures. Large city-scrappers and manufacturing units require extra regulation since they are more risky in terms of health and safety of employees and the public. However, small retail outlets do not need much regulation and inspection. The procedures for registration and inspection should keep these aspects in mind, making it easier for small retailers to start and operate a business. Ministry of Commerce and the local city development agencies should undertake training of staff and engineer their policies in a way to handle different businesses separately.

Training and Capacity Building of Staff

Capacity building of staff working at the offices responsible for registration and issuing permits is a must. Their training can make them significantly more efficient and aware of how to handle different cases. It can also improve coordination within an agency and also across agencies making the process of starting up considerably easier for businesses.

Employment

Pakistan lacks well-developed human capital. With only 57 per cent literacy rate and a large portion of the labour force being employed in agriculture, Pakistan's markets suffer from a deficiency in skills and appropriate entrepreneurial ‘talent' required for a thriving domestic commerce. Insufficient quantity of business schools and training institutes are unable to cater to the growing demand of employers and as such, most firms are made to hire unsuitable candidates. In addition, labour laws increase time and procedures for businesses to employ, terminate and deal with their workers. For even small to medium businesses, laws are rigid and can restrict functioning of businesses which act as a barrier to entry for new firms and forcing existing ones to evade laws and operate in the informal sector.

Under the Industrial and Commercial Employment (Standing Orders) Ordinance 1968, if an employer employs more than 20 employees, he has to formally register the relationship between employer and employee and the contract of employment, and contribute to the Worker’s Welfare Fund. This does not only increase procedures for businesses but also force small businesses that are unable to contribute much to the fund to evade the authorities and hire workers informally. Similarly, Employees Old-Age Benefits Act 1976 requires registration of firms with more than 10 employees with the Employees Old-Age Benefits Institution which takes 11 days, delaying establishment of businesses and restricting small to medium businesses. Apart from these laws pertaining to hiring and handling workers, employee termination can also be cumbersome. Pakistani laws establish procedures for terminating employees, although labour unions can resist layoffs creating problems for smaller businesses.

Training

Given the lack of skill development among Pakistani labour force, training is needed to conform the workers to the demands of the employers. Different firms should collaborate and set up their own training institutes in which they can educate the students in the skills desired by their organisation.

Merging and Devolving Procedures

To cut back delays the steps required for a business to comply with the various labour laws should be streamlined and reformed so that it takes fewer days for businesses to set up. Giving autonomy to the local governments to deal with these employee registration processes can help cut time. In the Punjab
Industrial Policy 2003, the Punjab Employees Social Security Institution registration was delegated to the district levels, speeding up verification of documents in Faisalabad and Lahore by 4 days.

Reforming Laws

Legal requirements are not friendly to smaller businesses leading to an increase in their procedures and expenses. To support smaller businesses, these labour laws should be relaxed and applied to firms employing over 100-150 workers rather than smaller and medium firms who have only 20 workers.

Taxation

Pakistan ranks 155th out of 179 countries in the amount of taxes collected as percentage of GDP since most of the taxes are collected from a narrow tax base. Most businesses in Pakistan are required to pay a total tax rate of 31.5 per cent (as percentage of profit) compared with 60 per cent in India and the South Asian average of 40 per cent. Although this tax rate is lower in comparison to other countries, the number of days required to comply with these tax requirements are high. In Pakistan, it takes an average of 560 hours for businesses to file their taxes. There were 75 changes made to the business tax code between 1990 and 2007. This makes the process of filing taxes extremely difficult for businesses. This is also one of the major reasons that accounts for a large informal sector in Pakistan.

Pakistan has undertaken some reforms in taxation. To eradicate tax evasion and to make the taxation process easier, three taxpayer units were set up along with 16 regional tax offices that conduct taxpayer satisfaction survey. Universal Self-Assessment Scheme was also introduced to limit contact between the taxpayers and the officials, minimising chances of corruption. Despite these reforms, Pakistan can still improve its tax structure further.

Simplification of the System

Although Pakistan has a lower overall tax rate and a lower profit tax than its South Asian neighbours, the average time taken to file taxes in hours per year in Pakistan is almost double that of the South Asian average. Pakistan’s Revenue Board can help firms by reducing the procedures and making the system less complicated through fewer administrative procedures.

Better implementation

While tax laws are in place, most people do not abide by them and tax evasion is widespread. Auditing system can be improved to ensure greater compliance. This can reduce fraud and tax evasion, and strengthen the tax system and the markets by lessening the burden on businesses operating formally. The Federal Board of Revenue can train their staff and employ more detailed evaluations to prevent such evasions and fraud.

Autonomy to local governments

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102 ‘Economic Freedom Index’, The Heritage Foundation, 2010
103 W Thirsk, ‘Tax Policy in Pakistan: An Assessment of Major Taxes and Options for Reform’, Working paper 08-07, Andrew Young School of Policy Studies, Georgia State University, 2008
104 540 hours in Pakistan compared to 284.5 hours average in South Asia
Taxes should be collected by local governments that are actually providing the services to the public. The local governments should be able to raise their own taxes and provide services accordingly instead of relying on federal funding, since they are a better judge of expenditure needs. Local governments should be given the autonomy to build a local tax base. This will reduce the pressure on the federal governments, as well as make it easier to enforce collection and increase the overall tax revenue.

**Enforcing Contracts**

The time and cost of enforcing a contract varies widely between different cities in Pakistan. This is shown graphically in Figure 10. Simply improving the performance of the least satisfactory to come up to the standard of the most efficient city would dramatically reduce time and costs, and thus provide a significant incentive for additional investment by firms.

**Figure 10: Time & Cost of Enforcing a Contract, 2009 (days and per cent of claim)**

![Graph showing time and cost of enforcing a contract in different cities in Pakistan.](source: Computed from data in World Bank, Cost of Doing Business in Pakistan, 2010.)

Pakistani businesses claim that courts are one of the top ten constraints to investment. To improve the current legal situation, National Judicial Policy (2009) has tried to bring justice to the local level besides the provincial and federal levels. The new policy aims to guarantee independence of judiciary, clearing of backlog of cases and reducing corruption. Some further measures can be taken to improve the situation.

**Commercial Courts**

Establishment of commercial courts can provide a specialised environment for the firms to deal with their problems. These courts can either be set up as separate entities or as a separate chamber in the existing courts. The courts can provide judiciary trained in handling business-related matters that can take decisions in a timely and impartial manner. Commercial courts were introduced in Mozambique.

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105 [http://enterprisesurveys.org/]
where the average time to resolve a commercial dispute fell from 1010 days to 730 days. Ministry of Law, Justice and Parliamentary Affairs and the Ministry of Commerce can try to establish commercial courts on a trial basis to see if they prove beneficial for Pakistani businesses.

**Strengthening Alternative Dispute Resolution (ADR) Systems**

ADR systems have proved successful in Pakistan. Karachi Centre for Dispute Resolution (KCDR) was set up to settle disputes through ADR system. This has proved successful, having solved 905 disputes. The Ministry of Law, Justice and Parliamentary Affairs and the Ministry of Commerce can facilitate the existing ADR systems as well as encourage entry of new ADR mechanisms in different cities, especially to deal with commercial matters.

**Time Limits**

Setting up time limits can lead to the quick handing of commercial cases. In Russia, mandatory time limits of 2 months for full hearing and 1 month for accelerated procedure were introduced. Judges were held accountable if a decision could not be made in the set time.

**Capacity Building**

Lawyers and judges should be trained in handling commercial cases effectively and quickly. The Ministry of Law, Justice and Parliamentary Affairs and the Ministry of Commerce should jointly hold seminars and training briefings for judges and lawyers on how to handle commercial disputes swiftly.

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106 Doing Business 2010, database
108 Doing Business 2010, Database
Conclusion

While Pakistan has taken several steps to promote competition in its markets, further reforms are required in improving domestic commerce, agricultural markets and industries. With increasing risks and cost of doing business due to deteriorating law and order situation as well as massive energy shortages, Pakistan needs to compensate its entrepreneurs and investors by enhancing its investment and business climate. By adopting certain administrative and legal reforms, Pakistan can considerably lessen the burden on its businessmen and help lower the costs of exogenous factors.

The main reforms needed to promote competitive and vibrant markets need to be initiated at the domestic commerce level. For promoting domestic commerce, city zoning laws and building regulations should be reformed to allow land to respond to market demand. The legal framework must also be strengthened to support the complex needs of diverse markets. Moreover, there is a need to push for openness and competition to bring international quality goods to the market and promote innovation. For agricultural markets, the Agricultural Produce Markets Act 1939 must be reformed to introduce competition such that private sector involvement is encouraged. Government involvement in storage and transport facilities, especially for agricultural produce, needs to be reconsidered so space can open up for private sector involvement. For reforms in the industries, consistency in policy is required along with reduction in government involvement in certain areas.

It is only through minimising the heavy government footprint from markets that the private sector can be allowed to function competitively and efficiently, emphasising the role of markets as a major driving force behind economic growth.

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