Background Paper

Promotion of Business and Investment in Pakistan

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Pakistan Institute of Legislative Development And Transparency

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PREFACE

Promotion of Business and Investment in Pakistan is a background paper authored by Dr. Hafiz A. Pasha, Managing Director, Institute for Policy Reforms (IPR); Professor, Lahore School of Economics & Beaconhouse National University & Former Advisor to the Honourable Prime Minister of the Islamic Republic of Pakistan, for the benefit of participants of the Pakistan-India Legislators and Public Officials Dialogue on Sharing of Experiences on Governance and Democracy scheduled to be held in Lahore and Karachi on October 06-09, 2015.

The paper outlines various developments that have taken place in the Business and Investment Sector in Pakistan over the years. Dr. Pasha outlines the strengths and weaknesses in the key policies adopted by Pakistan and suggests areas and possibilities of improvement in the sphere of Business and Investment in Pakistan.

Disclaimer

The views expressed in this paper belong to the author and do not necessarily represent the views of PILDAT.

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Abbreviations and Acronyms

GDP	Gross Domestic Product
GRP	Gross Regional Product
KPK	Khyber Pakhtunkhwa
SBP	State Bank of Pakistan
FBR	Federal Board of Revenue
FDI	Foreign Direct Investment
PML-N	Pakistan Muslim League-Nawaz
SEZs	Special Economic Zones
PSDP	Public Sector Development Program
MNC	Multi National Companies
PBIT	Punjab Board of Investment and Trade
SEDF	Sindh Enterprise Development Fund
BoI	Board of Investment
PPP	Public-Private Partnership

ABOUT THE AUTHOR

Dr. Hafiz A. Pasha is currently the Managing Director at the Institute for Policy Reforms (IPR) and also the Professor Emeritus at the Lahore School of Economics and the Beaconhouse National University. He has served from 2008 to 2011 as Chairman of the Advisory Panel of Economists to the Planning Commission, Convenor of the Economic Advisory Council of the Honourable Prime Minister of the Islamic Republic of Pakistan and Chairman of the Tax Advisory Council of Federal Board of Revenue. From 2001 to 2007, Dr. Pasha was UN Assistant Secretary General and Director of the Regional Bureau for Asia and the Pacific of UNDP. Earlier, Dr. Pasha held a number of important public appointments. He served as the Federal Commerce Minister, Federal Minister for Finance and Economic Affairs, Deputy Chairman/Federal Minister of the Planning Commission, and Education Minister in three Governments. Prior to this he was the Vice Chancellor of the University of Karachi, Dean and Director of the Institute of Business Administration, Karachi, and Research Professor and Director of the Applied Economics Research Centre, Karachi. Dr. Pasha has a M.A. from Cambridge University, U.K and PhD from Stanford University, U.S.A. He was awarded in 2005 the Congressional Medal of Achievement by the Philippines Congress. In 2012, he received the Engro Lifetime Achievement Award for excellence in the field of Social Sciences. He was nominated in 2012 as one of the top 100 Educators in the world by IBC, Cambridge, England. He has published over 150 books and articles in the fields of Governance, Public Finance, Urban and Regional Economics, Poverty and Social Development, Industry and Energy Economics.

Introduction

The period, 2004-2005 to 2007-2008, experienced an investment boom in Pakistan. This was a period when the economy witnessed a high GDP growth rate of over 6% per annum and foreign investment flows rose rapidly and reached an all-time peak in 2007-2008. Consequently, as shown in Table 1, Private Investment increased to 13.5% of the GDP and Total Fixed Investment to over 17.5% of the GDP.

However, after 2007-2008, the economy has faltered. The GDP growth rate has plummeted to just over 3%. Total Fixed Investment has fallen by over four percentage points to 13.5%, with most of the decline in Private Investment.

A number of negative factors have impacted the investment and growth in the last seven years. First, the high incidence of acts of terrorism throughout the country has greatly heightened risk perceptions of potential investors. Second, the worsening power shortage has even limited the utilization of existing capacity and electricity and gas supplies have not been forthcoming for new projects. Third, the law and order situation has severely deteriorated in the financial and industrial hub, Karachi. Governments, both Federal and Provincial, have tried to promote investment through friendly policies and attractive fiscal and other incentives. But these measures have had only a limited impact in a high risk business environment.

The objective of this paper is to highlight the trend in growth and investment at the Provincial level in Pakistan.[1] The rankings of the Provinces in promoting business are also presented. Proposals are formulated for strengthening the role of Provincial Governments in the promotion of Business and Investment in Pakistan.

Table 1: Trends in Investment in Pakistan (% of GDP)

	Public Investment	Private Investment	Total Fixed Investment
2002-2003	4.0	11.3	15.3
2003-2004	4.0	10.9	15.0
2004-2005	4.3	13.1	17.5
2005-2006	4.2	13.5	17.7
2006-2007	4.6	12.6	17.2
2007-2008	4.8	12.8	17.6
2008-2009	4.3	11.7	15.9
2009-2010	3.7	10.5	14.2
2010-2011	3.2	9.3	12.5
2011-2012	3.7	9.7	13.5
2012-2013	3.5	9.8	13.4
2013-2014	3.4	10.0	13.4
2014-2015	3.8	9.7	13.5

Source: Post Enumeration Surveys (PES)

1. For further details please see, the Provincial Growth and Investment Estimates collected by the Institute for Policy Reforms (IPR).

Trends in Provincial Growth and Investment

Estimates of the Gross Regional Product (GRP)[2] are not made in Pakistan, unlike India, by the official Statistical Agencies.

The estimates of the growth rates of the different Provincial economies are given in Table 2. During the high growth years, 2002-2003 to 2007-2008, the fastest growing regional economy was that of Sindh, with a Gross Regional Product (GRP) growth rate above 6%. The Industrial Sector was the leading sector, with a disproportionate presence in Sindh. After Sindh, the ranking in terms of growth rate was Khyber Pakhtunkhwa, followed by Punjab. The insurgency in Balochistan had severely restricted growth in the Province.

During the more recent low-growth period, 2008-2009 to 2014-2015, the rankings of Provinces have changed fundamentally. Khyber Pakhtunkhwa (KPK) has emerged as the fastest growing province, despite relatively high incidence of acts of terrorism. The Provincial Economy of KPK has benefited disproportionately from the fast growth in home remittances, expansion in the transport sector due to transit trade and the movement of NATO supplies to Afghanistan.

Punjab has continued to show a growth rate close to that of the National Economy. The biggest fall in GRP growth rate is that of Sindh, from over 6%, to just above 2%. The Industrial Sector has lost its dynamism and the business/commerce environment has been badly affected in Karachi by the breakdown in law and order. Balochistan continues to be straggler.

The level of investment in individual provinces reflects these growth patterns. Estimates of Gross Fixed Capital formation at the Provincial level in Pakistan are not available. As such, two proxies have been used to allocate investment among the Provinces. The first is the distribution of bank advances given by the State Bank of Pakistan (SBP). The second proxy is the level of construction activity in each Province as indicated by the withholding income tax of Federal Board of Revenue (FBR) on contractors.

The Provincial shares in the level and change in bank advances are given in Table 3. Punjab had a share of almost 42% in 2000-2001, which fell somewhat to 41% by 2007-2008 and has since risen by 2013-2014 to over 43%. An opposite pattern is observed in the case of Sindh. The share was approaching 35% in 2000-2001, which increased in 2007-2008, but has fallen by 2013-2014 to less than 33%. A big growth in share was witnessed in Islamabad in the earlier period from 9% to almost 13%. The share of KPK and Balochistan are relatively low at about 8% and 2% respectively.

Turning to the shares in construction activity, these are presented in Table 4. A similar pattern is revealed as in the case of bank advances. The share of Sindh rose initially, but has since fallen from almost 36% to 28%. The share of Punjab has visibly increased from 45% to 48%. The share of Islamabad has been fluctuating, while that of KPK has increased. The share of Balochistan continues to below at 4%.

Overall, Sindh has a significantly larger share in

Table 2: Growth Rates of Provincial Economies (%)

	1999-2000 to 2007-2008	2008-2009 to 2014-2015	1999-2000 to 2014-2015
Sindh	6.17	2.30	4.54
Punjab	4.85	3.40	4.12
KPK	5.47	5.66	4.28
Balochistan	3.10	2.10	2.60
Pakistan	5.21	3.24	4.29

Source: IPR Estimates

2. For further details please see the estimates of the Gross Regional Product (GRP) produced by the Institute for Policy Reforms (IPR) for the years 1999-2000 to 2014-2015..

investment than its population share. This has implied lower, though increasing, shares for the three other Provinces. There is also a relative concentration of investment in Islamabad, the capital city.

With regard to Foreign Direct Investment (FDI), it reached a peak, for the Country as a whole, of over $5 billion in 2007-2008. It has since fallen sharply to only $0.7 billion in 2014-2015. Again, this is a reflection of the risky business environment in the Country.

Four sectors account for the bulk of FDI currently. These are Oil and Gas exploration (31%), Telecom (22%), Industry (20%) and Financial Services (13%). Activity in the largest sector, Oil and Gas, is concentrated in Sindh and Balochistan. Financial Services are being developed more in Karachi. FDI in Telecom and Industry is more evenly distributed in different parts of the Country.

Table 3: Provincial Share in Total Bank Advances (June of Year; Rs. in Billion)

	2001	Share (%)	2008	Share (%)	2014	Share (%)
Overall	1276.1	100.0	3812.2	100.0	8051.6	100.0
Punjab	532.2	41.7	1564.3	41.0 (40.7)*	3491.6	43.4 (45.5)*
Sindh	443.5	34.8	1348.4	35.4 (35.7)	2641.2	32.8 (30.5)
KPK	100.2	7.9	227.4	6.0 (5.0)	555.7	6.9 (7.7)
Balochistan	24.3	1.9	70.7	1.9 (1.8)	170.2	2.1 (2.3)
Islamabad	117.8	9.2	443.7	11.6 (12.8)	923.2	11.5 (11.3)
Others	58.1	4.6	158.0	4.1 (3.9)	269.7	3.3 (2.6)
Advances to the Private Sector						
	2001	**Share (%)**	**2008**	**Share (%)**	**2014**	**Share (%)**
Overall	534.8	100.0	1057.1	100	2295.6	100.0
Punjab	246.6	46.1	455.4	43.1 (40.0)*	1006.4	43.8 (44.9)
Sindh	187.3	35.0	367.1	34.7 (34.4)	793.5	34.5 (34.4)
KPK	35.6	6.7	51.7	4.9 (3.1)	130.1	5.7 (6.3)
Balochistan	12.0	2.2	19.9	1.9 (1.5)	50.0	2.2 (2.4)
Islamabad	35.2	6.6	145.6	13.8 (21.1)	253.5	11.0 (8.7)
Others	18.1	3.4	17.4	1.6 (-0.1)	62.1	2.7 (3.6)

Source: State Bank of Pakistan (SBP)
Share in the increase in advances

Table 4: Regional Shares in Construction Activity (%)

	2008-2009	2009-2010	2010-2011	2011-2012	2012-2013
Sindh	35.4	35.8	29.5	27.9	28.2
Punjab	44.7	41.7	49.2	48.0	48.2
Islamabad	13.0	14.5	12.2	15.7	12.7
KPK	4.5	5.7	5.4	4.8	7.4
Balochistan	2.4	2.3	3.6	3.6	3.4
Pakistan	100.0	100.0	100.0	100.0	100.0

Source: Federal Board of Revenue, Government of Pakistan

Investment Policies

Federal Policies
The induction of the Pakistan Muslim League-Nawaz (PML-N) Government in June 2013 was expected to usher in a new era of investment, given that it is considered business-friendly. But in the presence of the previously mentioned factors and the prevailing severe energy shortage, investment by the private sector did not pick up fully in 2013-2014 and 2014-2015.

The sharpest decline has been witnessed in the Manufacturing Sector of over 2 % of the GDP. The other sector which has seen a big fall in the investment rate is Transport and Communications. By and large, much of the investment by the private sector today is in Agriculture (32 %), Housing (23%), Manufacturing (13%), Private Services (12 %) and Transport and Communications (10 %).

The new Government has announced a number of changes in various policies to promote investment. This indicates the strong 'investment orientation' of the Federal Government.

Investment Policy
The Investment Policy of 2013 builds on the liberal Investment Policy of 1997 of the second Pakistan Muslim League- Nawaz (PML-N) Government. The guiding principles are as follows:

1) Reduce the cost of doing business in Pakistan
2) Introduce one-window operations for investors
3) Creation of Industrial Clusters and Special Economic Zones (SEZs)
4) Link Investment Policy with Trade, Industrial, Fiscal and Monetary Policies

The investment regime is being liberalized by Free Entry to Foreign Investors, ease of Registration and Entry, Flexibility in Financial Procedures, Focus on Pioneer Industry, Development of Sector Specific Policies, Special Emphasis on Small and Medium-sized Enterprises (SMEs) and Renewable Energy. Measures are also proposed to provide greater investor protection.

Tax Policy
The steps taken by the PML (N) in the realm of tax policy to promote investment are as follows:

<u>Budget, 2013-2014</u>
1) The maximum corporate tax rate reduced by 1 % annually from 35 % to 30 %
2) Investment in Special Economic Zones (SEZs) will enjoy tax holidays of 10 years as compared to 5 years earlier and import of machinery will be exempted from customs duty

<u>Budget, 2014-2015</u>
1) Extension of duty-free facility of machinery imports to the textile sector
2) Reduction in GST rate on tractors from 17 % to 10 %
3) In order to attract FDI, the corporate tax rate levied on foreign investors is being reduce to 20 % from 33 %
4) Number of import duty slabs reduced to six, with maximum rate of 25 %

Monetary and Exchange Rate Policy
The major move was the revaluation of the rupee by almost 12 percent in early 2014. This has significantly reduced the upfront costs of investment, based on imported machinery.

However, given sizeable increase in bank borrowing by the Government, there has been more 'crowding out' of the Private Sector. Credit to the Private Sector by scheduled banks was Rs. 208 billion in 2014-2015, 44 % less than the level attained in 2014-2015.

The mark-up rate on the Long-Term Financing Facility has been reduced from 11.40 % to 9 %, especially for exporters. Similarly, the rate on export finance has been brought down to 4.5 %, following the reduction in policy rate to 7 %, in response to the lower inflation.

Development Priorities
The PML-N Government has begun to focus much more aggressively on removing infrastructural bottlenecks to investment. These are primarily water for agriculture and power for industry. There is strong evidence that this public investment 'crowds in' private investment. The Public Sector Development Program (PSDP) allocations at the Federal level for the two sectors are given in Table 5. These reached a peak in 2013-2014, and have since declined in 2014-2015. The priority has shifted to highways.

Level of Profitability
The sharp fall in the level of investment has created large 'gaps' in different industries. This has raised the profitability of existing units and any recent entrants. Therefore, subject to the willingness to accept somewhat higher risk, Pakistan offers very high returns or investment to both domestic and foreign investors.

The average return on equity of public limited companies, including many MNCs, appears to be U-shaped between 2007 and 2013, as shown in Table 6. As expected, the return on equity was high in 2007 and 2008. It fell sharply in 2009. Thereafter, the return has risen sharply, reaching almost 23% in 2013. A similar path is observed in the case of return on capital employed.

Provincial Policies
The Provinces have also oriented their Public Sector Development Program (PSDP) allocations to attracting more private investment. This has involved higher shares of irrigation and energy in the respective PSDPs, as shown in Table 7. This is most pronounced in Punjab and Sindh, although there is scope for increasing the shares further.

The Provincial Governments have also set up specialized institutions to promote and facilitate private investment, especially FDI. The Punjab Board of Investment and Trade (PBIT) has been set up as a Company under Section 42 of the Companies Ordinance. The Sindh Board of Investment (SBI) has an impressive website, which provides information on the special advantages of investing in Sindh alongwith a listing of investment opportunities, including sector studies and project feasibility reports. The Government of Balochistan has also established a Board of Investment (BoI).

Table 5: Federal Public Sector Development Program (PSDP) Allocations for Water and Power

	Public Sector Development Programme (PSDP) Allocation for Power and Water		
	Power	**Water**	**(Rs. in Billion) Combined Total**
2012–2013 (R.E)	78.8	45.3	124.1
2013–2014 (R.E)	128.4	54.0	182.4
2014–2015 (R.E)	108.5	46.0	154.5
% of PSDP			
2012–2013 (R.E)	20.3	11.7	32.0
2013-2014 (R.E)	30.2	12.7	42.7
2014-2015 (R.E)	20.0	8.5	28.5

Source: Budget in Brief, Ministry of Finance, Government of Pakistan
Note: R.E=Revised Estimate

One of the primary mechanisms for inducing investment that has been adopted by the Provincial Governments is the establishment of Industrial Parks and SEZs. Two such Parks have been set up in Punjab. The first is the Ruyi Masood Textile Park in Faisalabad and the second is the Garments City, as part of the Pak-China Industrial Zone at Kala Shah Kaku (along the Motorway).

Similarly, the Sindh Board of Investment has set up the Education City Project, Marble City Project, the first SEZ in Khairpur and the Sukkur Dry Port. A Sindh Enterprise Development Fund (SEDF) has also been established.

Ranking in Ease of Doing Business

The World Bank presents annually the rankings of countries in different indicators of ease of doing business. For Pakistan and a few other countries, the Bank has gone ahead and prepared sub-national

Table 6: Return on Investment of Non-Financial Public Limited Companies

Years	Average Return on Equity (%)	Average Return on Capital Employed (%)
2007	25.5	18.4
2008	20.8	15.5
2009	11.9	7.6
2010	16.8	9.8
2011	19.9	12.1
2012	13.8	8.6
2013	22.6	14.4

Source: State Bank of Pakistan (SBP)

Table 7:Development Priority in Provincial Public Sector Development Programs (PSDP) (% share to Irrigation & Energy)

	2012-2013	2013-2014	2014-2015
Punjab	8.5	14.8	18.1
Sindh	10.2	14.9	17.3
KPK	5.0	5.2	5.3
Balochistan	14.8	16.1	15.5

Source: Provincial White Papers

rankings at the level of cities in different provinces. These rankings for 2014 are presented in Table 8.

With regard to starting a business, the best cities of Pakistan are Islamabad, Faisalabad, Lahore, Karachi and Peshawar. Overall, the cities of Punjab and Islamabad do better in terms of ease of doing business. The primate city, Karachi, does poorly in granting construction permits, registering property and payment of taxes. This is probably a reflection of poorer quality of governance and more corruption by the provincial bureaucracy.

Overall, the position with regards to promoting business and investment in each Province is given in Chart 1.

Promotion of Investment

There are a number of areas where the Provincial Governments can do more for the promotion of business and investment, especially by learning from the experience of other countries like India. Some of these areas are listed below.

Table 8: Sub-National Rankings in Ease of Doing Business

Province/ City	Ease of Doing Business	Starting a Business	Dealing with Construction Permits	Registering Property	Paying Taxes	Trading Borders	Enforcing Contracts
Sindh							
Karachi	9	3	10	11	11	1	3
Hyderabad	11	12	11	1	3	5	10
Sukkur	13	11	13	11	11	2	7
Punjab							
Lahore	3	3	3	4	3	13	8
Faisalabad	1	2	6	1	3	4	2
Rawalpindi	10	8	5	7	3	12	10
Multan	2	6	1	7	3	5	4
Sheikhupura	5	9	8	5	3	7	8
Gujranwala	6	13	2	6	3	10	4
Sialkot	11	12	11	1	3	5	10
Islamabad	4	1	8	3	1	11	10
KPK							
Peshawar	8	3	6	9	10	8	8
Balochistan							
Quetta	12	6	12	13	2	9	13

Source: World Bank

First, the Provincial Governments can develop more effective laws, regulations and financial mechanisms for setting up of Public-Private Partnerships (PPPs) in different areas. Some promising projects for PPPs are marketing centers, low cost housing, drip irrigation, storage facilities, improved seed varieties, service centers/rental facilities of agricultural machinery, industrial estates, public transportation, highways, health and crop insurance, micro finance, business and security services, vocational and technical training, etc.

Second, the Provincial Governments may play a more aggressive role in the promotion of power generation and transmission projects. Article 157 of the Constitution of the Islamic Republic of Pakistan enables the Provinces to perform this function, including 'wheeling' arrangements for local supply of power to industrial parks and other clusters of production units.

Third, the 18th Amendment has opened up the possibility of Provincial Governments engaging in market-based or bank borrowing, subject to the fulfillment of some conditions, for financially viable projects in sectors like power. The Governments of Punjab and Sindh are already taking some steps in this regard.

Fourth, the Provincial Governments must aim to reduce the transaction costs to production units by cutting down the points of interaction with functionaries of provincial line departments. This will imply some deregulation and merger of functions. Also, investors should be facilitated by the setting up a 'one-window' process of sanctions and approvals.

In conclusion, Pakistan has been going through an investment slump over the last seven years. Fortunately, decisive action is being taken now to tackle terrorism through Zarb-e-Azb and implementation of the National Action Plan. The Chinese Government is supporting the large investment under CPEC. Both Federal and Provincial Governments must try and actively contribute to the process of investment revival through measures of the type described above.

Chart 1:Pluses and Minuses of each Province in promoting Investment

Province	Pluses	Minuses
Punjab	1. Better Law and Order Situation and Security 2. High Ease of Doing Business	1. High levels of Power Loadshedding 2. Big Gas Shortage
Sindh	1. Less Power Load shedding and Gas Shortage 2. Better Access to finance 3. High Investment Potential in gas Exploration	1. Poor Law and Order Situation 2. High Cost of Doing Business
Khyber-Pakhtunkhwa	1. Relatively Buoyant Economy 2. Less Power Load shedding	1. Bad Security Situation 2. High Cost of Doing Business
Baluchistan	1. High Investment Potential in the Mining Sector	1. Slow Growth of Economy 2. Bad Security Situation 3. High Power Load shedding 4. High Cost OF Doing Business

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