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PRIVATE SECTOR INVESTMENT CLIMATE ASSESSMENT OF BALOCHISTAN

Prepared for USAID/Islamabad

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FINAL REPORT

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BACKGROUND AND PURPOSE OF ASSESSMENT

This private sector investment climate assessment of Balochistan was prompted by the desire of USAID/Islamabad to explore the possibilities for the inclusion of activities to enhance private sector development as a part of continuing activities of the Balochistan Area Development Project (BALAD). The BALAD project has been under design and implementation since 1984 in the Makran division of Balochistan. The purpose of the project, as stated in the Project Paper, was "to accelerate the integration of the Makran Division of Balochistan into the socio-economic mainstream of Pakistan and to improve the quality of life in Makran through improved roads, water and agricultural infrastructure and strengthening Provincial and Divisional planning, management and human resources."

The project included a number of elements to alleviate the lack of infrastructure and facilities in Makran. The project activities to date have focussed on road construction, upgrading and maintenance; water sector improvements; special development activities such as the construction of schools and health facilities; institutional development and data collection activities. Considerable results have been obtained on all fronts with the exception of the reconstruction of the Bela-Awaran Road and its extension to Turbat. Current mission plans are to split off the road project from continuing activities in the BALAD project. Current BALAD activities are scheduled to be completed in September 1990. However, USAID is currently considering an extension of the BALAD project until the end of 1991 while it decides the shape of continued efforts in Balochistan and in Makran, specifically.

The purpose of this assessment is to assist in the design of continued USAID activities in Balochistan; specifically, to assess the climate for private investment in the Province (with a specific focus on Makran) and to recommend appropriate areas of activity to be undertaken by USAID to enhance the development of the private sector there.

LIST OF ACRONYMS

ADB	Asian Development Bank
ADBP	Agricultural Development Bank of Pakistan
BALAD	Balochistan Area Development Project
BDA	Balochistan Development Authority
BEL	Bankers Equity, Limited
DFI	Development Finance Institution
FCB	Foreign Commercial Bank
GOP	Government of Pakistan
IDBP	Industrial Development Bank of Pakistan
IESC	International Executive Service Corps
LBI	Louis Berger International
NCB	National Commercial Bank
NDFC	National Development Finance Corporation
NWFP	Northwest Frontier Province
PBC	Pakistan Banking Council
PIA	Pakistan International Airlines
RDFC	Regional Development Finance Corporation
RONCO	RONCO Consulting Corporation
SBP	State Bank of Pakistan
SRD	SRD Research Group
USAID	United States Agency for International Development

NOTES: Balochistan is spelled in two ways in this report. This is due to a recent change in the official spelling of the province. The name of the province was formerly spelled Baluchistan; the new official spelling is Balochistan. Therefore, quotes from older documents and listings of older documents use the previous spelling, whereas this report and recent document use the current official spelling.

Approximate exchange rate at the time of this report:
1 United States Dollar ($) = 21.5 Pakistani Rupees (Rs)

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EXECUTIVE SUMMARY

The Government of Pakistan is currently moving toward increased private sector involvement in the economy. This has improved the climate for private sector investment, from both foreign and domestic sources. The current Prime Minister has placed a high priority in opening the economy to the private sector.

However, there are considerable problems in moving from a centrally-controlled economy with heavy public sector involvement to one which is more market-oriented and open to competition by private companies. There is a residual distrust of the private sector by many bureaucrats as well as by many in the population. This must be overcome in order to allow a market economy to flourish. Furthermore, Pakistan suffers from a number of constraints including civil unrest in various regions, infrastructure deficiencies, rent-seeking behavior by bureaucrats and politicians, perceived political risks and government control and limitations on capital markets.

The constraints in Balochistan make private investment even more difficult. The lack of infrastructure is even more pronounced there. Furthermore, the shortage of water and of resources limit the types of possible investments. The strong tribal influences which often provide a hostile environment for development in general and a distrust of outsiders were frequently mentioned by persons interviewed. Other constraints include a shortage of skilled labor, backward agricultural, fishing and industrial practices and a lack of education and entrepreneurial spirit on the part of the average citizen of Balochistan.

On the other hand, certain current private sector activities in Balochistan offer potential for the future. These include the production of certain fruits and vegetables in northern Balochistan, increased mining of mineral deposits, fishing on the Makran coast, development of certain new fruit varieties on the Makran coast, improved roads (particularly the USAID-financed Turbat-Arawan-Bela road extension). The extensive number of micro and small scale enterprises in the urban areas also offer room for expansion and growth. Much can be done to enhance private investment in these sectors as well as to develop local institutions to provide support services to the private sector in the province.

Although this consultancy principally derives from USAID activities in the Makran Division, the consultants analyzed possible activities to assist in the development of the private sector in Balochistan, as a whole, as well as putting special emphasis on Makran. It became clear to the consultants during this exercise that the development of the private sector in

Makran alone would present certain constraints which could be more satisfactorily addressed through a program to assist the private sector in Balochistan as a whole, particularly in relation to the development of local private sector support institutions. Consequently, this report suggests a means to address both levels of potential USAID activities.

Political stability is an issue which may be important at the national level, but is less important at the provincial level in terms of private sector investment. The predominant issues relative to business confidence are the strain in relations between the national and provincial governments and the influence of tribalism on provincial politics. Concern over these issues gives rise to anxiety over investment in Balochistan, both by foreign investors and by Pakistani investors from other parts of the country. The basic lack of infrastructure and a shortage of skilled labor also impact on the perceptions of local Balochistan businesspersons as well. They were not optimistic that these conditions would change much in the near future. However, as local businesspersons they are seeking assistance in improving the business climate as much as possible.

Institutional credit is available in Balochistan from various sources, notably the ADBP, IDBP, RDFC, BEL and the national commercial banks. It is available to formal businesses at average interest rates of 12 - 16%. The NCB's provide most of the seasonal agricultural credit, whereas the ADBP provides most of the medium to long-term agricultural credit, some of it for agribusiness projects. The IDBP loans range between Rs 500,000 and 300 million for terms of 5 - 10 years. BEL has an office in Quetta, but its activities have been minimal. The Asian Development Bank and the World Bank have given funds to the ADBP and IDBP for financing of small scale enterprises. It is uncertain as to whether these funds are reaching micro and small scale enterprises effectively to date.

Two problems which were cited relative to the availability of credit were the high level of equity and collateral required by the banks for institutional credit. Furthermore, it was stated by various Quetta businessmen that the feasibility studies necessary for the banks to approve loan projects were either beyond the capability of the businessmen themselves or too costly to obtain.

Labor is Balochistan is largely rural and agricultural-based (68%). Another 10% of the population is engaged in trade. Only 9% is engaged in manufacturing, mining, construction or electricity. The density of the population is low at 12 persons per square kilometer, compared to a national figure of 127/sq. km. This demonstrates the limited labor force available in Balochistan. Other than the standard Pakistan labor legislation, there are no particular labor laws which apply specifically to Balochistan, with the exception of a 25% local labor requirement. This can be waived, however, when the skilled technicians are not available locally. Politically, however, local labor utilization can be an important issue. Businessmen consistently complained about the shortage of skilled labor in the province and the need to import skilled labor or to develop programs to train locals, preferably on-the-job-training.

Most transport of goods in Balochistan is by road. The road conditions are generally very poor, however, and this limits the ability of the province to export agricultural products to markets in Punjab and Sind as well as outside Pakistan; by the time the goods reach the markets, they are frequently damaged and difficult to sell. The improvement of the Bela-Awaran-Turbat road by USAID will definitely help to make it easier to ship goods out of Makran to Karachi. It is questionable, however, as to how much the balance of trade, as it were, between Makran and the Sind will improve. Many believe that the improved road will only increase the amount of goods imported into Makran. Much will depend upon how the Makrani's take advantage of increased opportunities and develop scarce resources to produce and export more. Nevertheless, there will be an inevitable increase in economic activity along the new road and this activity will offer opportunities for USAID to enhance further economic development related to the increased transportation, particularly in the services sector.

Current private investment in Balochistan is overwhelmingly micro and small scale. A survey of industries was performed by the Balochistan Directorate of Industries and a report issued in 1987. Excluding the Hub Chowki area, carpet and handicraft training centers and mining concessions (which are largely inoperative), 669 establishments were listed. Of these, 619 (93%) had 10 or fewer employees. Of the remaining 50, only 15 had more than 25 employees. Furthermore, most of the private investment in Balochistan comes from provincial sources.

The potential for increased private investment in Balochistan is limited to a few key areas. The most promising appear to be the following:

Increased production of fruits and vegetables in the Quetta and Makran regions to be marketed either domestically or exported. Improved collection, sorting and packaging techniques will be required in addition to improvement of road conditions. There are substantial limitations on exports of temperate climate fruits and vegetables from Quetta since they enjoy no particular climatic or proximity to export markets advantage. However, discussions with the SRD Research Group indicated a possibility of growing high value fruits in Makran for export. This needs to be explored. There may be some room for expansion of domestic markets, however, for fruits and vegetables grown in Balochistan, particularly as a result of growing season advantages.

Improved fish processing and transportation of fresh fish and fish products from Makran to Karachi appear to have considerable promise, especially once the electrical power plant in Pasni and the road from Turbat to Bela is completed. Recent improvements in the harbors of Pasni and Gwadar should also help to increase opportunities in this sector, provided they are properly managed. A fishmeal plant was recently built in Pasni which is now operating. The private investors sell the fishmeal in Karachi for poultry feed. These same investors have received a loan to construct another fishmeal plant in Gwadar.

Transportation-related enterprise in Makran hold much promise once the road from Turbat to Bela is completed. Vehicle repair shops, restaurants and food markets, ice-making plants and hotels are only some of the immediate possibilities. USAID should look closely at ways it can assist in enhancing the possibilities of the development of these small enterprises along the road.

Additional financial and technical support to formal small scale agribusinesses in the Quetta region should be investigated. Particular attention should be given to the possibility of providing incentives through loan portfolio or other guarantees as a means to create a venture capital fund or to entice an existing Pakistani private leasing company to locate in Quetta. These two options might help the small businesses in that region to overcome the two hurdles of high equity/collateral requirements and feasibility study preparation to obtain credit for new or expanded business operations.

Ways to support the development of formal and informal, micro and small scale enterprises in the Makran District should be investigated. The venture capital fund and/or private leasing company mentioned above could also serve Makran. In addition, an approach to the development of enterprises as utilized by the Aga Khan Rural Support Program should be explored. A substantial research effort should be mounted to ascertain the composition and needs of formal and informal micro and small enterprises in Makran. This effort could also determine the best ways to increase the involvement of the women of Makran in enterprise development.

Other potential opportunities for private sector investment in Balochistan were mentioned by various sources. USAID may want to consider the feasibility of some of these options over the coming months. These opportunities include mining operations, electrical power plants, small scale cement plants, increased production of limes, well-digging using modern methods, and a coastal ferry.

This report concludes with specific recommendations for USAID interventions to develop the specific areas mentioned above with potential to increase private investment in Balochistan. Some of these interventions would be based in Quetta, whereas others would be based in Makran. The discussion of interventions includes suggestions regarding possible institutions or contractors to implement those interventions.

In conclusion, although there are very substantial constraints on the development of the private sector in Balochistan, there are some limited opportunities which offer promise and can be supported by USAID. The interventions suggested build upon USAID experience to date, both in Pakistan and in Balochistan, and involve minimal extra expense to USAID. The results of these interventions and suggested research in the short-term should provide a good base on which to develop further interventions to assist the private sector in the province.

INTRODUCTION

Overall Economic Context of Private Investment in Pakistan

Pakistan has undergone changes in economic policies over the past 30 years which have created uncertainty for private investors. Pakistan is still recovering from its socialist policies of the 1970's. However, Pakistan is currently moving toward privatization of its economy and the government is actively promoting policies to engender private sector growth, including foreign investment. Pakistan is actively soliciting private sector involvement in the agricultural processing sectors as well as in energy production and other areas.

Nevertheless, much anxiety remains within both the local and foreign business community due to various reasons, including

- bureaucratic mistrust of the private sector and slowness in implementing policy reforms
- civil unrest in Karachi and Hyderabad
- infrastructure deficiencies which cause major project implementation delays and considerable added costs to production
- rent-seeking behavior on the part of government bureaucrats and politicians
- perceived political risks due to political unrest on the Afghanistan border and in Kashmir
- government control and limitations on capital markets

In spite of these uncertainties and problems, many private investors and companies have done well in Pakistan and are currently looking toward expansion of their activities. The economy of Pakistan is still very vibrant and could rebound significantly within a policy and regulatory environment that would promote the private sector. For example,

- Pakistan's small-scale industries are widely dispersed geographically and contribute 30% of manufacturing output and 80% of manufacturing employment
- Numerous private companies have successfully negotiated petroleum exploration concessions
- The private sector accounts for 85% of Pakistan's coal production
- Pakistan is a net exporter of agricultural based commodities
- Although only the foreign banks are privately owned, the national commercial banks and development finance institutions have been devoting more and more of their financial resources to the private sector

In summary, the economy of Pakistan has considerable real potential for growth if the central government continues moving toward privatization and private sector growth.

Predominant Factors Affecting Private Investment in Balochistan

Unfortunately, the potential for improvements in the private sector in the country as a whole do not reflect the substantial constraints which exist in some of the provinces, particularly those bordering Afghanistan and Iran. As the province with the largest land area of Pakistan (44%), an arid climate, mountainous terrain, shortage of water, a frequently violent tribal society, an average population density of 12/km, and a literacy rate of 10%, Balochistan suffers more than most from those constraints.

The constraints on private investment, if not on development in general in Balochistan, were constantly brought up during interviews with government officials, private businesspersons, bankers and other interested parties. Chief among them were the lack of infrastructure and water. They were followed by a shortage of resources and skilled labor, resistance to development by tribal leaders and a distrust of outsiders, backward agricultural, fishing and industrial practices, and a lack of education and entrepreneurial spirit on the part of the average citizen of Balochistan.

Lest one be totally disheartened, there are some bright spots on the horizon.

- Balochistan produces most of the temperate-climate fruit for Pakistan and benefits from a growing season which gives it comparative advantage to Sind and Punjab for some crops during the year
- The province has significant mineral deposits and leads in national production of barytes, chromite, coal, and natural gas
- Fishing on the Makran coast offers potential for expansion and development
- The dates from Makran are recognized as having the best quality in Pakistan and represent about a third of the total national production
- The Makran Division offers some promise for the development of certain fruit varieties, such as grapes, for export using more efficient irrigation methods and better means of transport
- When the road between Turbat and Karachi is completed, transportation costs will be significantly reduced and commercial activities along the road will certainly increase.
- Many small and microenterprises currently exist in urban areas in Balochistan. Means to develop these

enterprises through technical assistance, training and credit need to be explored.

The areas cited above will require a good deal of effort to develop appropriate interventions and to develop the institutional mechanisms to deliver them. However, USAID can build on its existing experience with the BALAD project and others such as the ACSCA studies in order to develop the capacity to address these needs in Balochistan.

Approach Taken for This Assessment

This assessment was conducted during the month of June 1990 by two private sector specialists. Stephen C. Silcox, an expert in market research and microenterprise development, and Gilbert P. Lane, an expert in investment finance and government regulation, were hired by Louis Berger International to perform the assessment. The consultants met with private businessmen, government officials, USAID officials and contractors and representatives of banking and finance institutions in Islamabad, Quetta, Turbat, Posni and Karachi to discover the key constraints and opportunities for private sector development in Balochistan. In addition, they reviewed various documents provided by USAID and others on the socio-economic conditions existing in Balochistan. (The scope of work and workplan are presented in Annexes 1 & 2.)

The scope of work for this consultancy provides for activities in two phases. This report represents the results of the first phase and is meant to give a general overview of the private sector investment climate in Balochistan Province, in general, and Makran Division, in particular. It also provides direction for further activities to be undertaken under phase two of the scope of work, which will involve in-depth investigation and exploration of the feasibility of USAID support in areas identified during this first phase. This report also makes some recommendations to USAID on types of interventions which might prove fruitful and possible institutions to utilize or develop in addressing the development of the private sector in Balochistan and Makran.

It should be pointed out that although this consultancy derives principally from USAID activities in the Makran Division, the consultants analyzed possible activities to assist in the development of the private sector in Balochistan as a whole as well as putting special emphasis on Makran. It became clear to the consultants during this exercise that the development of the private sector in Makran alone would present certain constraints which could be more satisfactorily addressed through a program to assist the private sector in Balochistan as a whole, particularly in relation to the development of local private sector support institutions. Consequently, this report suggests a means to address both levels of potential USAID activities. For implementation reasons, USAID may chose to only implement those activities mentioned for the Makran Division. However, the consultants believe that the two-tiered approach presented in this report would have the most beneficial effect on private sector development in Makran.

Critical Aspects for Private Sector Development

One comment which was repeated by a number of interviewees and in documents reviewed was the need for Pakistan and Balochistan to focus on markets first, then production. In other words, much effort have been made in the past to develop productive capacities only to discover that the product made did not have sufficient domestic or export markets to justify increased production. Project-driven enterprises, be they either public or private sector, will not succeed unless a thorough analysis is made of the potential for increased markets for the product.

One idea which recurrently surfaced during discussions on private sector development with both government representatives and private businesspersons was the concept that the government could step in and develop a factory or enterprise when the private sector would not establish one, and then disinvest and turn it over to the private sector. The consultants for this assessment would assert that the reason, in most cases, why the private sector has not developed the factory or enterprise is that private entrepreneurs do not view it as a profitable activity. In cases where the government disinvests, it must usually sell the facility at less than its development costs or provide heavy subsidies or protected markets. The first alternative is a waste of taxpayers' money and the latter two militate against competition and more efficient production with the loss to the consumer of cheaper and better quality products.

Furthermore, most private enterprise is developed around the world due to a recognition by entrepreneurs that a market exists for a product and that they are in a position to satisfy that market. It also involves a risk-taking attitude that gives the entrepreneur the drive to succeed and make the project or enterprise "work" at all costs. This is at the heart of the concept of an "entrepreneurial spirit." The nurturing of this spirit is the key to the development of a vibrant private sector. Training can give persons knowledge, but it cannot instill this spirit. The entrepreneurial spirit is developed as a consequence of a number of factors, some cultural, some familial, and some due to the enhancement of opportunities for individuals. Governments need to provide the enabling framework for the development of this entrepreneurial spirit, since they cannot force people to be entrepreneurs.

For the purpose of this assessment, it may be helpful to review the context in which the consultants view the development of the private sector, i. e., those aspects which are essential for the development of the private sector in any country or area. These aspects are:

1. An <u>enabling environment</u> provided by government which may consist of

   - total nonregulation of the private sector or a "laissez faire" attitude (hardly existing anywhere in the world today for obvious historical reasons) or,
   - heavy subsidies to the private sector or protected markets(which can result in large income disparities and market distortions) or,
   - key incentives given to development of the private sector, such as special tax treatment, access to special financing or infrastructure and subsidized training or,
   - government purchases from the private sector through a competitive system of procurement or,
   - discouragement of rent-seeking behavior by government officials or
   - a mixture of the above

2. The desire and drive of private sector entrepreneurs to discover new ways of making a profit based on past <u>business experience</u> and a <u>risk-taking attitude</u>

3. A <u>market information system</u> which will permit knowledge of the markets and production necessities that will allow private entrepreneurs to develop businesses which can take advantage of market niches

4. <u>Perception of market opportunities</u> by businesspersons and an education level which will allow them to understand the workings of the business (or at least the need to hire someone who does

5. <u>Natural resources</u> which can be exploited

6. <u>Infrastructure (physical, human, financial, institutional, communications and transport)</u> which will allow modern businesses to be developed and competitive in today's environment

7. <u>Acceptance of change, new ideas and the benefits of private sector development</u> by the populace

This assessment will attempt to review how these critical aspects are addressed in Balochistan and the prospects for change.

POLITICAL STABILITY AND BUSINESS CONFIDENCE

At the National Level

Although much remains to be done to change the bureaucratic machinery and its latent resistance to private sector development in the economy, the government has taken many of the proper steps to re-establish the private sector. 15 international companies involved in agribusiness were surveyed by RONCO as a part of the Analysis of Corporate Sector Constraints in Agriculture studies for USAID. The survey[1] revealed that,

a. two companies which have operations in Pakistan are "generally positive" on conducting business in Pakistan;

b. two companies which have operations in Pakistan are considering or are proceeding to expand operations despite their concerns on the overall economic/political/business climate in Pakistan;

c. one company is considering establishing operations in Pakistan if the overall economic/political/business climate in Pakistan continues to improve;

d. three companies might be interested in establishing operations in Pakistan if the overall economic/political/business climate were better in Pakistan;

e. seven companies are not considering establishing operations in Pakistan, for three basic reasons:
   (1) they feel Pakistan is an unstable economic and political area;
   (2) there is "insufficient information" available to them on opportunities in Pakistan (i.e., they do not know if there is a market for their products in Pakistan or if there are raw materials they would use in an economic way to market internationally); and
   (3) there has been "no cooperation" from the Pakistan banks and government sources that they have contacted over the years.

This survey, although limited, indicates that companies already located in Pakistan have reason to believe that the private business climate is improving, but a number of companies which have not yet begun operations in Pakistan require further encouragement and evidence to locate in Pakistan.

Nevertheless, foreign investment in Pakistan is significant.[2] In 1987, the total net foreign indebtedness amounted to $1,762.5 million of which 19.4% was to international financial institutions, 18.46% was to the USA, and 14.59% was to the UK. Of this total the bulk was in manufacturing (47.26%) and commerce

(36.34%). Mining and quarrying was third with 7.96%. On the other hand, of the net inflow of foreign investment in 1987, 56.68% was for mining and quarrying, 25.57% was for commerce and only 9.77% was for manufacturing. Insufficient data was available to determine whether this increase in inflows for mining and quarrying was a trend. The USA was, by far, the single largest source with inflows in 1987 of 67.34% of the total. (The second largest source was the UK with 8.24%.)

A report[3] by the Economics Office of the U.S. Embassy in Islamabad on the investment climate in Pakistan stated,

> Since 1977, the Government of Pakistan has taken numerous steps to revive the private sector and attract private foreign capital. Its objective has been to focus industrialization efforts on export-oriented, capital intensive and high technology industries. Prime Minister Benazir Bhutto has placed increasing emphasis on more foreign investment...

However, the report goes on to say,

> Foreign investors remain cautious about investments in Pakistan due to the perceived level of government control, a history of cumbersome investment sanctioning procedures, high effective corporate tax rates, a strict indigenization policy, and weak infrastructure.

In sum, it appears that the Pakistan government is well on its way to improving the private sector business climate, but will require considerably more effort to convince the private sector that the espoused policy change is being translated into concrete changes on the ground.

At the Provincial Level

Foreign Business or National Pakistani Business Perceptions

Issues relative to political stability or atmosphere take on a different context when considered on the basis of the Balochistan province.

At present, relations between the central and provincial governments are considerably strained on a number of issues, according to various sources interviewed. Some of the issues involve the general structure of political power, such as the struggle for provincial autonomy, while others reflecting political maneuvering impact on important economic issues, such as the power plant at Hub and the copper mining project at Saindak. Budgetary restraint necessary at both levels of government does not help the need for more infrastructure and other development assistance support. Given the firm stances taken by Baloch leaders vis-a-vis the central government, it would appear that the strain will continue for some time and will obviously have an effect on business and economic development.

Within the province it appears that the very strong tribal tradition and rivalries hamper actions and programs at the provincial government level. Disputes in the formative stages of project design and disputes at the implementation stage, particularly when two or more tribal areas are involved, frequently occur. Even provincial government agencies cite tribal problems as frustrating efforts on certain development projects. The heavily ingrained and dominant tribal society of Balochistan appears to be one of the major constraints on development and, therefore, business expansions or start ups. The firm hands that rule tribal societies tend to resist any change that may alter the centuries-old power relationships. In many cases, they can be physically hostile to the introduction of new technology and education, no matter how rudimentary. Kidnapping and killing of government agents or expatriate technical advisors (as well as tribal leaders and followers themselves) is not uncommon in Balochistan. Where outright hostility is not found, bribes or "royalties" are often demanded to locate on tribally-controlled land, even if it is for the benefit of local residents! This applies to new schools, extension of electricity service, introduction of new farming technology and irrigation, as well as the establishment of new factories or mining operations.

A discussion of business confidence needs to be set against the harsh realities of Balochistan and an understanding of the many constraints and impediments to business and private sector development. The lack of a business presence in the province of national Pakistani business concerns appears to be a reflection of two principal impediments cited by various sources - As "outsiders" i.e., not from the same tribe, they are not made to feel welcome and this antipathy coupled with the scarce resource and infrastructure base, leads them to find little to encourage them to locate in Balochistan. Whatever comparative advantage Balochistan might have in a particular sector pales in comparison to the obstacles to be overcome for a foreign or even Pakistani national business to locate in Balochistan.

Foreign business concerns, even the old line British firms found elsewhere in Pakistan, are nonexistent in the province. Given the limited resource base, lack of infrastructure, tribal obstacles and other factors, it is highly unlikely that U.S. or other foreign companies will find it attractive to operate to any appreciable magnitude in Balochistan.

Local Business Perceptions

The confidence level of the provincial private sector businessperson met in Quetta and Turbat is also very low. They face the same harsh realities which are faced by external private sector investors, even (although, perhaps to a more limited extent) the tribalism factor. Virtually every discussion with local businessmen, bankers and government officials in the province concentrated on the constraints of private investment in Balochistan. The various factors cited were as follows:

a) Lack of infrastructure
b) Lack of education - primary, secondary & vocational
c) Shortage of trained laborers
d) Shortage of resources, particularly water
e) Resistance to new technology by farmers
f) Shortage of managers (even locals who are trained often seek positions elsewhere due to the difficult conditions in Balochistan and lack of opportunities for advancement)
g) The "trader mentality" of local businessmen (of the 1000+ members of the Quetta Chamber of Commerce and Industry, only 10 or fewer are involved in manufacturing)
h) Distance to national markets and limitations on access by government (including trade with Iran and Afghanistan)

Some of the above may change over time but will require considerable efforts by the government and a change in attitudes by the general populace. (It was interesting to note that credit and financing, which is covered in depth later in this report, was rarely mentioned as a constraint by the individuals interviewed.)

One interview with the owner of a Quetta fruit and vegetable processing plant which was established by his ancestor over 100 years ago revealed that his two brothers had opted to move to Karachi and establish garment factories there rather than reinvest in Balochistan. This anecdotal story is indicative of the relative unattractiveness of private business development in Balochistan, even in Quetta, when compared to Punjab and Sind.

The intention of this analysis is not to discourage efforts for private sector development in Balochistan. Rather, it is meant to lower expectations of the potential for private sector development and provide a realistic assessment of the background against which USAID and others should judge the types and level of effort that might impact on private sector development in Balochistan.

INDUSTRIAL DEVELOPMENT POLICY

National Investment Code

For details on national private investment policies and investment code as well as foreign exchange policies, repatriation of earnings, taxation and customs duties, please refer to Annex 5. Specific policies and concessions which apply to Balochistan are described below.

Provincial Investment Code

The federal government recently attempted to address the special needs of the less developed areas of Pakistan. In June 1990, the Ministry of Industries announced a new rural industrialization policy which would be applicable to all rural areas of Pakistan but also seems clearly aimed at the "lagging" areas of Balochistan and NWFP. The major provisions of this policy are as follows:

a) Industrial loans from institutions at a concessional rate of 8%
b) A one-year grace period on loan repayment
c) Tax holiday for 8 years for new industries
d) Exemption from import duties on machinery as well as sales tax and license fees
e) Priority treatment by institutions in the processing of submissions for financial assistance
f) Concessional rates for transportation from the National Logistics Cell (trucking) and the railways; thus enabling local products to reach markets in a cheaper and a more efficient manner
g) No questions asked about the source of equity financing for industries (ostensibly to attract money made from black market activities)

The above and other relatively minor measures have been adopted at the federal level to provide financial and fiscal incentives to enhance development possibilities in rural and lagging areas. At the provincial government level, efforts have largely concentrated on improving the physical climate for new industrial development. The Balochistan government views its role as primarily one of providing the infrastructure to spur development. A number of industrial estates have or are being established in 9 population centers throughout the province. These are being established and managed by the Balochistan Development Authority (BDA) with support from the Directorate of Industries and Commerce. BDA is also actively pursuing the establishment of public sector business ventures which it intends to later sell to the private sector.

Since lack of infrastructure heads almost everyone's list of major constraints in the province, any effort to correct the physical climate needs to be applauded and encouraged. However, discussions with businessmen in the Quetta area revealed that even after years of effort, infrastructure within the Quetta industrial estate is insufficient and that the two most important inputs - electricity and water - are inadequate in amount and continuity to sustain normal industrial operations. A study of industrial opportunities in Balochistan in 1988 stated,

> Such industrial estates undoubtedly facilitate the process of setting up a new business. However, their effectiveness in promoting the industrialization of the interior of Baluchistan is necessarily limited. The incentives offered are no more attractive than those in some other parts of the country which enjoy clear advantages in terms of access to markets and, in some cases, raw materials.[4]

Given the abovementioned and other constraints noted elsewhere, the granting of additional financial and fiscal incentives, such as those recently announced by the federal government, may have limited effect. Balochistan has enjoyed, for at least 20 years, a special status relative to tax holidays (formerly 5 years and now increased to 8) and other benefits similar to those recently adopted nationwide. Except for the Hub Chowki area, which is in reality an extension of Karachi and which is developing due to the extreme overcrowding of industrial areas there, these incentives appear to have had little effect in other areas of the province. The differentials between standard rates and concessional rate incentives would not seem to be sufficient to overcome the more basic physical and institutional constraints. Concessional rate incentives can only be effective when other factors are equal. This is clearly not the case when one compares the advantages of private investment in the Sind or Punjab to Balochistan. This attitude was recently expressed by a writer in the Balochistan Times in an article commenting on the new Rural Industrialization Policy. He remarked, "The reason for the failure of tax concession policies is the absence of infrastructure - physical and human - and the peculiar socio-economic relationship amongst people of the backward areas."[5]

CREDIT AND FINANCIAL POLICIES

General Observations Regarding the Financial Market in Balochistan

Discussion of the role of the formal financial sector in private sector development must be considered in relation to the scale of present and possible future demand for financing of business enterprises in Balochistan. Several major points should be kept in mind when considering the availability of credit and possible constraints due to financing:

1) Most businesses within Balochistan (excluding the Hub Chowki area) are relatively small scale operations. The Provincial Ministry of Industries and Mineral Resources published an "Industrial Directory of Balochistan" in 1987. Excluding the Lasbella District (Hub Chowki), Carpet and Handicraft training centers, various coal and mining concessions and those without data on number of employees, the directory listed a total of 669 establishments. Of those, 619 (93%) had 10 or fewer employees; of the remaining 50, only 15 had more than 25 employees. The figures speak for themselves regarding size of operations.

2) The activities of a large segment of Pakistan's financial institutions are not relevant to the size of business entities in Balochistan.

3) Those Karachi-based financial institutions that do have offices in Quetta to service the province are often hard pressed to find and package suitable investment opportunities. Their home offices have adequate access to both local and foreign exchange funds which could be utilized. Although Quetta offices have not been given a quota of funds to be placed, it was clear from several discussions that they are continually being urged to find opportunities to be funded.

4) Given the limited number and size of potential investments, the amount of funds that could be absorbed and realistically put to work in the province is insignificant compared to the amount available within the Pakistan system. The availability of funds for formal businesses, except for equity capital, does not appear to be a problem.

5) On the other hand, although the consultants were unable to spend much time investigating the issue, reports indicate that there are limited credit funds being disbursed to the informal sector, composed mainly of

microentrepreneurs. A report for the World Bank by Tariq Husain of DRMS in April 1989 on microenterprise credit and support services stated, "While mandated targets for credit to the small scale sector are intended to ensure credit access to this sector, rigid institutional and sectoral credit allocations encourage supply driven credit, freeze market shares of existing financial institutions, and hence undermine the efficiency of financial markets. Financial institutions fill mandatory quotas by lending to the largest of the small scale industries."[6] This factor could have a substantial impact on the development of the private sector in Balochistan, which appears to be mainly composed of informal microenterprises and formal small scale enterprises.

Institutional Credit Sources and Terms

The financial system of Pakistan has a considerable array of institutions with various, and sometimes overlapping, functions.

> Pakistan's financial system is fairly well developed and diversified. It consists of : (i) the State Bank of Pakistan (SBP); (ii) five nationalized commercial banks (NCBs); (iii) nineteen foreign commercial banks (FCBs); (iv) three specialized scheduled banks; (v) nine development finance institutions (DFIs); (vi) twelve leasing companies; (vii) two stock exchanges; (viii) a housing finance corporation; (ix) several insurance companies; and (x) a number of cooperative banks. The SBP regulates and directs the financial system. Within the policies set up by the Government and the SBP, the Pakistan Banking Council (PBC) monitors and coordinates the activities of the NCBs, while the Ministry of Finance oversees the operations of the other financing institutions. With the exception of the FCB's, leasing companies, non-life insurance companies and the two stock exchanges, all the other major financial institutions are either wholly, or partially owned and controlled by the Government.[7]

The source of funds for most of the private sector activity in Balochistan, excluding the Hub Chowki area near Karachi, comes from the cooperative banks, nationalized commercial banks and DFI's. Many of the institutions which deal with large scale private sector business do little, if any, business in Balochistan.

Short-term agriculture credit for production comes primarily from the cooperative banks and the NCB's. Most of the credit obtained from the Agricultural Development Bank of Pakistan is for medium to long term "development" loans (about 80%). The ADBP has 37 branches in Balochistan. It has been promoting agribusiness loans, but has not had many takers in Balochistan. The provincial office of the ADBP in Quetta stated that it has given no agribusiness loans this past year. Their "development" loans have a range of 5 - 10 years and charge an interest rate of 12% with a 3% penalty in case of default. They require an equity ratio of 70/30% in Balochistan (the normal rate is 60/40%) for projects over Rs. 2.5 million. For projects under Rs. 2.5 million the equity ratio is reduced to 5 - 15%. The Annual Report of the ADBP for 1989 reveals that Balochistan received 4% of its total loan portfolio as of June 30, 1990; loans disbursed to Balochistan since inception of the ADBP amounted to 3.2% of the total; and Balochistan had the lowest recovery rate of any province for loans disbursed since the inception of the ADBP (75.8%).

The Industrial Development Bank of Pakistan (IDBP) has a provincial office in Quetta and 5 regional offices in Balochistan. Its loans range between Rs 500,000 and 300 million. The terms of its loans are 5 - 10 years with an interest rate of 15 - 16% (except that loans for the purchase of Pakistani-manufactured equipment are only 6%). It has disbursed a total of 166 loans in Balochistan (7.6% of total loans country-wide) since inception of the IDBP.

The Regional Development Finance Corporation (RDFC) has an office in Quetta and is charged with making loans in "lagging and undeveloped" areas of Pakistan. It finances agribusiness and industrial projects and appears to be relatively active in Balochistan. It has made 47 loans in Balochistan ranging from RS 25,000 to 25 million since its inception and also will provide loans for working capital purposes. It has financed projects in transport, minerals, and service related businesses including hotels, tourism, and private schools and hospitals. Its loans are for 1 - 8 years at 15% (with the same 6% for Pakistani manufactured equipment.)

The National Development Finance Corporation (NDFC) has an office in Quetta, but it loans only to areas outside of the RDFC's jurisdiction. It currently has about 10 projects in Balochistan, but all except one (which is a ghee and cooking oil plant in Quetta) are for enterprises in the Hub Chowki area. Minimum project size for an NDFC loan is Rs 7.5 million.

Bankers Equity Ltd. (BEL) maintains an office in Quetta, but its activities have been minimal. It deals mainly with larger projects and has a minimum project size of Rs 10 million. It has financed two projects in Balochistan (outside of the Hub Chowki area) over the past years - a gypsum plant and cement plant. In both cases, the plants have closed due to problems with tribal disputes. BEL would like to be more active in Balochistan but has trouble finding bankable projects. Some hope was evidenced that current attempts to privatize BEL may result in changes which will help it to improve its efforts in Balochistan.

No leasing companies are currently operating in Balochistan, at least outside of the Hub Chowki area.

Most loans for commerce and trade are obtained from the NCB's.

The Asian Development Bank and World Bank have given funds to the IDBP and ADBP for financing of small scale enterprises. This topic requires further research to determine the effectiveness of this financing in reaching the microenterprises and small scale enterprises. The study by Husain cited above would indicate that there is considerable room for expansion of loans to these enterprises. (See Annex 6 for a description of informal sources of credit and financing for microenterprises.)

Credit Availability versus Equity Requirements

Financing a new or expanding an established business in the formal private sector involves two types of funds - debt and equity. On the debit side, there are a number of institutions prepared to advance financing provided they are presented with a financial plan for a feasible project. Discussions with Bankers Equity Ltd., the Regional Development Finance Corporation, the Agricultural Development Bank of Pakistan and other financial institutions indicated that there is no shortage of funds for lending and rates of interest or terms for such loans are not a key constraint on private investment. (Other sources, however, cited problems with collateral requirements and land appraisal that limit access to credit. This issue is discussed further below.) It, therefore, is highly doubtful that the increased availability of debit financing, even on highly concessional rates of interest or terms, would bring forth an increased number of viable private sector investments or would be a key factor tipping the balance in favor of a positive investment decision.

Obtaining debt financing is largely a function of having sufficient collateral and a sufficient equity cash investment. No matter how feasible a project looks on paper, both of the above components become major stumbling blocks particularly in an area with the risk factor and investment climate of Balochistan.

Throughout Pakistan but particularly in Balochistan, it seems that lenders not only require a high ratio of equity to debt but additional collateral over and above what may be justified by lending against the assets of the business alone. This additional collateral, often an unrelated price of land or other physical asset, is generally beyond the means of the typical business borrower in Balochistan. Some sources interviewed stated that typical collateral requirements on borrowings are often 150% and reach as high as 200%.

Potential for a Venture Capital Fund in Balochistan

Regarding equity financing, institutions frequently require a 30 - 40% hard equity contribution as against advancing 60 - 70% of project costs in the form of debt - no matter how overly collateralized. This is usually beyond the means of most emerging private sector business sponsors. A source of additional equity investment is generally needed. One possible avenue, i.e. a small venture capital company, might be a way to promote new investment in Balochistan. According to an Asian Development Bank analysis of the financial sector in November 1989,[8] none of the financial institutions in Pakistan are currently in a position to take a direct equity position in businesses. Even Bankers Equity Ltd., which was formed in 1980 to fill this gap and mandated to provide equity capital to the private sector only, has for various reasons ceased that activity and is now prohibited from such investments. The ADB report cited above stated that the ADB was assisting in the establishment of a venture capital fund in Pakistan. Information was not available on its current status.

Limited Capabilities of Balochistan Businesspersons to Analyze Business Propositions and Prepare Financial Feasibility Studies

Another major constraint related to the financial sector, whether debt or equity financing, appears to be the limitations of Balochistan businesspersons to analyze and put together a feasibility study and funding request which will satisfy financial institutions. The members of the Quetta Chamber of Commerce and Industry cited this limitation and are interested in developing this capability within the Chamber. Bankers repeatedly stressed that most loan applicants are either ill-prepared or don't make the effort because the applicants are convinced they will not succeed without the proper "contacts" to approach the institutions.

Regarding preparation of a financial request, i.e. proper documentation and preparation of a feasibility analysis, expanding and emerging private sector entrepreneurs are generally incapable of preparing a proper financing submission on their own. The Pakistan financial institutions do not assist in feasibility preparation; the function of their staffs are to appraise submissions prepared by the entrepreneurs. The only recourse or source available for preparation, according to the bankers, are private consultants which, due to expense or geographical location, are beyond the reach of local entrepreneurs. If a more dynamic private sector is to emerge in Balochistan, some way must be found to overcome this major constraint.

LABOR RELATIONS, POLICIES AND CONSTRAINTS

Perspectives on Labor in Balochistan

The discussion of labor matters as they relate to private sector development in Balochistan and Makran needs to be set against the background of current employment and related factors. An overriding fact is that the province contains only 6% of the population of Pakistan. The population is 85% rural including a significant number of nomads and immigrants from Afghanistan. Given the size of the province, density is low at 12 persons per square kilometer compared to a national figure of 127 persons per square kilometer. Reflecting this fact, there are few concentrations of population in towns or cities to constitute a labor base. Furthermore, as mentioned elsewhere, the predominance of a tribal attitude amongst the populace is an important factor. In summary, Balochistan contains a relatively small work force spread over a vast area. In addition, the literacy rate of 10% and the low mobility of the population (due to lack of skills and training as well as social inhibitions) contribute to limit the availability of skilled labor in the province.

The composition of the workforce in Balochistan is broken down by sector and compared to the national workforce as follows[9]:

Sector	Percentage of Distribution	
	Provincial	National
Agriculture	68%	54%
Trade	10	11
Transport	6	5
Community Services	7	10
Manufacturing	4	13
Construction	4	5
Mining & Electricity	1	1
Other	0	1

As one can see, the residents of Balochistan are more concentrated in agriculture than the average in Pakistan. Trade and transport occupations are about the same as the national average. The key discrepancies of Balochistan are in the areas of manufacturing and community services. This reflects the poor industrial base in Balochistan and the shortage of social and other services.

National and Provincial Labor Legislation

The national laws and regulations relative to labor are the key laws relative to labor in Balochistan. The only local additional requirement that goes beyond national regulations is a requirement for a minimum of 25% local labor utilization. This requirement can be waived however, when local labor is not available. (A good discussion of national labor issues is found in Annex 5, page 17.)

Businessmen interviewed in Quetta agreed that there were no special labor laws relative to Balochistan (other than the 25% minimum local labor), but felt that the national laws were enforced more rigorously in the province.

Availability of Labor

All sources cited a shortage of skilled labor in the province. As a result, much of the labor is imported from Punjab and Sind province. A reluctance on the part of some Baloch to engage in skilled labor occupations was also mentioned by some. This shortage is further exacerbated in the Makran Division by the historical connection and proximity to the Gulf States. Buzdar mentions the large scale exodus of Makranis to Karachi in the 30's and 40's when slavery was abolished. A later wave took place during the oil boom in the Gulf States. This emigration had the effect of reducing the availability of agricultural labor and changing the social structure in the Makran area so that owners of farms now have to work the land themselves.[10] With the oil boom over, some of the Makranis are now returning; but there is often a reluctance to return to old patterns, especially with their new-found wealth accumulated while overseas. A walk through the market area of Turbat and interviews with various microentrepreneurs revealed that many of the technicians working there were from Punjab or Sind. Some are in business for themselves and others are working for local entrepreneurs.

There is also a shortage of managerial skills in Balochistan. The reason given was that the opportunities for someone with a university education in Balochistan were limited and many leave for other parts of Pakistan. Given the limited industrial base and the general shortage of government and social services, it is easy to understand the outmigration. It is a fact of life everywhere that the best and the brightest are usually attracted to large cities that hold promise of a better career and more opportunities for advancement. Balochistan will require considerable development before it can be competitive for degree holders.

Rates of Compensation

Businessmen in Quetta complained that the rates of compensation paid in Balochistan were double those paid in other parts of Pakistan. They asserted that the higher rates were needed to attract skilled labor from Punjab and Sind to work there. This may be the case, but this would seem to contradict the shortage of skilled labor in Balochistan. A survey of daily wages of construction workers in different cities showed higher wages paid in Karachi.[11] A carpenter made Rs 116/day in Karachi compared to Rs 110 in Quetta in 1989. Likewise, an unskilled laborer was paid Rs 57 in Karachi and Rs 51 in Lahore compared to Rs 38 in Quetta and Peshawar. More research needs to be made on actual rates of compensation in order to determine if wages paid in Balochistan are, in fact, competitive with other provinces, considering all the factors involved.

Political Issues

The provincial 25% local labor requirement reflects a concern for providing employment opportunities for residents of Balochistan. This issue of local labor utilization relates to the tribal concerns and would appear to be a political issue which must be dealt with by contractors and other employers in Balochistan. One person interviewed who has been closely involved with the Belgian-financed port improvement project in Gwadar mentioned that the Balochistan Student Federation had called a strike against the contractors for the port because they felt that construction jobs should first go to local residents. The contractor agreed to hire locals first, but when insufficient applicants showed up, the contractor was forced to hire from outside the province and the political issue died down.

TRANSPORTATION

Current Modes of Transportation within Balochistan and for National and Export Markets

The bulk of transportation in Balochistan, for commerce, industry and passenger traffic is by road. It is also served by rail transport, but this is limited to links between Quetta and Sibi and onward into Sind. Air traffic is mainly passenger-oriented. 11 towns in Balochistan are served by Pakistan International Airlines (PIA). However, except for Quetta, most are served by propeller-driven aircraft with limited cargo capacity. All flights are internal in Pakistan except for a flight between Gwadar on the Makran coast and Muscat, Oman.

The mountainous terrain impacts upon the road layout in Balochistan. One main road runs north/south from Quetta through Kalat, Khuzdar and Bela and terminates in Karachi. Another road runs from Quetta through Sibi and on to Jacobabad and Sukkur where it links up with the National Highway. There are two principal east/west roads which lead to Iran - one in the north and one in the south. Finally, there are two main roads going northeast from Quetta that enter Punjab and NWFP, respectively, and one main road going north from Quetta towards Kandahar in Afghanistan. The roads leading to the main roads are extremely rough and often impassable in bad weather.

Except for exports to Iran and Afghanistan which are prohibited by the government and therefore limited to smuggled goods, the principal markets for most exports (what little exports there are) are via Karachi. In addition, many of the items produced in Balochistan for the national market also tend to be shipped via Karachi.

This assessment will concentrate on the two roads linking Quetta with Karachi and the Turbat-Arawan-Bela road in Makran since they are the key roads for private sector development purposes. Furthermore, it will concern itself mainly with the problems the roads present in shipping fresh fruits and vegetables from Quetta to Karachi and with the shipment of fruits and vegetables and fish from Makran to Karachi, since these activities hold the most promise for private sector development in these areas.

Shipments Between Quetta and Karachi

Excessive transportation costs were mentioned by most of the businessmen interviewed. Since the market for agricultural produce and manufactured goods in Balochistan is limited, many are shipped to Punjab and Sind. In cases where the raw materials must be shipped in for manufacturing purposes, the transportation costs normally make the price of the finished goods too high to be competitive with industries located where the raw materials are found. This is one of the reasons why textile factories established in northern Balochistan failed. Furthermore, the main roads are not in good condition. When this is coupled with the poor farm-to-market roads, it creates problems with the condition of the fruits and vegetables received in Karachi. These problems can be somewhat mitigated by refrigerated trucks and proper handling and packaging, but this is not being done currently.

Rail transport does not appear to be a good alternative for movement of perishables either. A report done by Hawaiian Agronomics for the ADB in 1986 had the following comments on rail transport,

> The Government of Pakistan operates the railroad system and according to figures provided in the Sixth Five Year Plan, the ratio of haulage by rail vs. truck is now nearly 1:4. Even with the targeted growth and increase in expenditures on the railway system as outlined in the Plan, the Pakistan Railways cannot compete with truck transport in hauling fresh fruits and vegetables.
>
> The rolling stock available to growers for hauling is minimal and access to current lines is limited. Long delays and turnaround times have placed the railways at an increasing disadvantage with respect to perishable commodities. Now, trucking rates are lower than the corresponding tariff by rail. ...The competitive position of Pakistan Railways vis-a-vis truck transport is typical of the situation in Europe and the United States.[12]

Shipments between Turbat and Karachi

Most shipments between these two points are one-way. Consumption items, raw materials and manufactured goods come from Karachi to Turbat and the trucks generally return empty. This fact is demonstrated by the fact that in 1983, a total of 397,000 metric tons of freight was shipped into Makran and a total of 59,500 metric tons of freight was shipped out.[13] The amount of agricultural commodities and industrial goods shipped in was about half and half. The outbound goods were about 70% agricultural commodities and 25% livestock. A substantial portion of the outbound agricultural commodities were, undoubtedly, fresh and dried fish and dates since these are the principal commodities produced by Makran.

Potential Impact of the Turbat-Awaran-Bela Road

The obvious impacts of the completion of the Turbat-Awaran-Bela road is the shortening of the time taken to travel the distance (estimated to be reduced to half the current travel time), longer life of vehicle due to less wear-and-tear resulting from better road conditions, reduced transport costs, and increased traffic.

In terms of impacts on private sector development, the road will make certain improvements in agriculture production and fisheries feasible, provided that other substantive improvements are also made. Regarding increased agricultural production and exports, these will be feasible only if water resources are developed and if sufficient national or export markets exist for the crops developed. Conversations with Samuel Daines of SRD, which is currently commencing a horticultural development project in Pakistan for USAID, indicated that Makran might hold some promise for the development of grapes, melons and, perhaps, other fruit crops for export. Conversations with various experts in date production and marketing as well as review of documents on the subject generally do not indicate that the potential export market for dates is very advantageous to Pakistan or that the national market can grow much more. On the other hand, the dates from Turbat are allegedly better quality than the dates grown around Sukkur, so it might be possible to increase market share in the national market. There is substantial potential for private sector investment to improve fish processing and transport activities. These topics are discussed further below in the section of this report on potential for increased private investment in Balochistan.

The other area where the road will impact on private sector development is in the area of transport-related businesses. The need for vehicle repair shops, restaurants, rest houses, etc. along the road will create a substantial engine for development. The potential for assisting in the establishment of micro and small scale enterprises of this nature is a good potential activity for USAID.

CURRENT PRIVATE INVESTMENT IN BALOCHISTAN

Types and Size of Industries and Trade

The overwhelming majority of industries located in Balochistan are micro and small scale enterprises, as evidenced in the Industrial Directory of Baluchistan printed in January 1987. Of the 669 establishments listed (excluding the LasBella District/ Hub Chowki area, carpet and handicraft training centers, various coal and mining concessions, and those without data on number of employees), 619 (93%) had 10 or fewer employees. Of the remaining 50, only 15 had more than 25 employees. And this directory only included enterprises which were registered. Substantial numbers of informal microenterprises may not have been included in the survey.

Of the 1000+ members of the Quetta Chamber of Commerce and Industry, less than 10 are actually engaged in industrial activity. The rest are basically traders, with some of them engaged in illegal border trade with Iran and Afghanistan, according to informed sources in Quetta.

In terms of types of industries, the following list comes from the directory cited above (with the same exclusions).

Brick Kilns	43
Coal Mining	9
Ice Factory	16
Dairy Farm	37
Hotel & Restaurant	36
Flour Mills	260
Engineering	69
Rice Mills	17
Oil Expeller	3
ARA Machine	9
Furniture	30
Soap Factory	8
Poultry Farm	13
Steel Works	6
Footwear	35
Bakeries	17
Barytes Mining	1
Pharmaceuticals	1
Aluminum Factory	1
Food Processing	8
Tobacco Crushing	16
Marble Products	1
Lubricating Oil	1

Cold Storage	1	
Printing Press	6	
RCC Pipe Factories	3	
Stone Crushing	5	
	---	(loss of 17 enterprises due to
Total	652	consolidation in some categories)

It should also be noted that the directory did not list any industries in the Makran Division. Obviously the directory is incomplete since there are many small scale enterprises similar to those listed above operating in Makran.

Distribution Channels

The consultants were unable to investigate the distribution channels of the various enterprises listed above within the time constraints of the consultancy. Further research could be conducted on a subsector basis if USAID desires to determine the distribution channels of particular industries. This could be helpful in order to understand particular constraints on either obtaining raw materials or markets for products from specific subsectors. Suffice it to say that many of the enterprises listed above must market their products locally with relatively simple channels of distribution.

Financial Participation by Companies Outside Balochistan

Conversations with businessmen, bankers and government officials in Quetta, Turbat, Karachi and Islamabad indicated that most of the private investment in Balochistan comes from provincial sources. The number of national Pakistani companies actually operating establishments within Balochistan is minimal. The only evidence of any foreign investment was by individual Pakistani's who have emigrated to other countries and who had come from Balochistan.

Restraints on Private Sector Investment in Balochistan by Government Policies or Unfair Public Sector Competition

The principal restraints on private sector investment in Balochistan have been listed in previous sections of this report. The only area cited by businessmen where the government has discouraged private sector investor investment is in the issuance of a "No Objection Certificate". Government representatives stated that this certificate is used by the government only for zoning purposes, e. g., to keep offensive industries from locating in a residential area. However, private businessmen claim that the government is too restrictive and this inhibits private investment. The members of the Chamber of Commerce and Industry also complained about the restriction on trade with Iran and Afghanistan by the central government. Since Balochistan has long-standing cross-border commercial ties, it is very plausible that restrictions on that trade have hampered some private sector investment in Balochistan. On the other hand, it can be argued that smuggling goods in from Iran, Afghanistan, and, along the Makran coast, from the Gulf States has helped many businessmen in Balochistan profit from some of the restrictions on trade.

POTENTIAL FOR INCREASED PRIVATE INVESTMENT IN BALOCHISTAN

Opportunities - Most Promising

Based on the foregoing analysis, the consultants have determined that certain, limited opportunities exist for increased private sector investment in Balochistan. The emphasis of a program to increase private investment should concentrate on the development of formal small scale agribusinesses in the northern region around Quetta and the development of micro and small scale (both formal and informal) agribusiness, fish processing, and enterprises related to transportation in the Makran Division.

Fresh Fruits and Vegetables - Quetta Region & Makran

The production and marketing of high value fruits and vegetables is the principal activity within the province that appears to have potential for expansion and improvement and one of the few activities around which some level of private sector investment and development is possible.

With the exception of the possibility of new grape varieties, melons and other potential fruits introduced into and grown on a commercial basis in Makran during the winter, there seems to be little potential for exports. The supposedly rich area in and around Quetta and the north is climatically located in a belt where other producing areas in the world have comparative advantages. What increased market potential that does exist appears to be in the domestic urban markets. Balochistan has some seasonal advantages in fruits and vegetables which can be expanded upon. This appears feasible for the province provided that improvements in the level of collection sorting, chilling, packing and refrigerated transport to domestic urban centers are made. A higher level of processing of fruits and vegetables aimed at the export market does not appear particularly attractive since processed fruits and vegetables can be kept for a long time and other more advantageously situated producing areas have better and more established access to markets than Balochistan.

As previously covered, there appears to be possibilities for increased date production in the Turbat area, provided increased domestic or export markets can be expanded. The RDFC has recently approved a loan to set up another date processing plant in Turbat. The family receiving the loan is also in the process of setting up an agricultural inputs company for Makran, according to BALAD staff.

Fish Processing and Transport of Fresh Fish on Makran Coast

A visit to Pasni and discussions with various government and private sector persons involved in the fisheries sector revealed considerable potential for developing this industry. It currently suffers from primitive methods of fishing and processing the fish. Furthermore, much of the fishing catch is sold offshore to trawlers from Dubai and other countries as well as from Karachi (although one source stated that many Karachi trawlers are lying idle). There are no trawlers in use along the Makran coast which are owned by the fishermen themselves.[14] The ADB completed a port improvement project in Pasni a year ago, but problems still exist due to lack of harbor staff and the fact that the harbor is very shallow. Nevertheless, much of the infrastructure is now in place. A new power plant (40 megawatt capacity) is nearing completion and should help the development of the area, including Turbat to the north. In addition, a Belgian-financed port improvement project is currently underway in Gwadar which will also help to modernize the fish industry along the Makran coast.

The consultants viewed a recently constructed and operating fishmeal plant in Pasni and later met with one of the investors in Karachi. It has been in operation for less than a year, has its own power supply (lower-priced Iranian gasoline provides a relatively cheap source of power along the border in Makran), and sells its fishmeal to the domestic poultry feed market in Karachi. The same four investors (all originally from Makran - 2 still live in Makran) have received approval for another loan to construct another fishmeal plant in Gwadar. The fishmeal produced is evidently not of sufficient quality to sell on the export market due to its shortage of protein. However, local prices for fishmeal have been better than export prices recently - although recent imports of soybean meal are taking their toll on fishmeal prices.

The former Director of Fisheries for Balochistan now is the Chief Executive in Karachi of a Singapore-based fishing company established by a Pakistani there. He has plans to try to develop tuna fishing along the Makran coast through training the local fisherman on how to use a "hook" system (rather than net) which allows the fish to stay alive longer during transport to market.

All sources noted the increased possibility for fresh fish transport to Karachi when the road from Turbat to Karachi is completed due to decreased travel time and better transport conditions. The poor roads from Pasni and Gwadar to Turbat will still be a constraint. Also, the preparation of the fish for transport will have to be improved in order to achieve proper quality. The fish processing plants in operation in Pasni which were inspected by the consultants (one government operated and one private) employed very primitive and unsanitary methods.

There is much scope for private investment in installing modern small scale fish processing facilities both in Pasni and Gwadar. This would not entail canning of fish, however, since the technology in canning is much more advanced.

Transportation-Related Enterprises in Makran

The completion of the road between Turbat and Bela will open up much potential for micro and small scale enterprises along the road. Vehicle repair shops, restaurants and food markets, ice-making plants and hotels immediately come to mind. As usually happens when a road is completed, economic activity generates further economic activity and as more people settle close to the road, the need for more services develop. There is much scope for developing the institutional base in Makran so it will be ready when this activity begins to occur. The development of support institutions as described below will assist these transportation-related enterprises to get established when the opportunities arise.

Financial and Technical Support to Formal Small Scale Agribusinesses in the Quetta Region

As noted, Balochistan is basically composed of micro and small scale industries. For the foreseeable future, this is the level of activity where interventions should be targeted. Support of the private sector at this level seems to be the most feasible alternative at this stage of Balochistan's development. However, the establishment and/or expansion of activities in this sector will encounter one major roadblock, i.e, financing for equipment purchases and working capital. Micro and small scale entrepreneurs do not usually have the ability to prepare feasibility analyses that the formal financial sector requires for financing. Furthermore, only in rare cases would a small scale entrepreneur have sufficient capital as collateral to satisfy a bank loan officer. His recourse is therefore to the informal sector. The central government has funds available for financing support of small scale industries, but they appear to be going only to the higher end of formal small scale industries.[15]

One financing source available to this sector which seems to match its needs as to method and scale would be the **private sector leasing companies** that have surfaced in Pakistan over the last few years. This method of operation involves the financing of purchases of individual pieces of equipment for which the equipment itself becomes the collateral. Based upon discussions with one leasing company in Karachi, which operates nationally, their experience with small lease programs has been quite satisfactory. In fact, they view this as a profitable area in which to expand their activities. That company, incidentally, is currently looking to expand geographically and is considering a Quetta office. It could provide financing for enterprises in both the Quetta region and Makran.

A previous section dealt with the financial sector and outlined some of the problems associated with finance relative to the development of the private sector in Balochistan. A key problem is that of adequate equity capital in most transactions, i.e. the general inability of most entrepreneurs to come up with free cash to satisfy the 30 - 40 % equity contribution requirement. One source that could be established to alleviate this shortfall is a venture capital fund. Two highly experienced private sector-oriented financial managers raised this possibility. One of them suggested that a venture capital company could be formed in Quetta to make equity investments in Balochistan companies. He was convinced that he would be able to sell shares to private individuals in Balochistan and elsewhere in Pakistan. He believed that such an approach would be feasible if some form of guarantee program on the investments in the portfolio could be given. Likewise, the scope of the activities of the fund could include all of Balochistan.

The venture capital fund company could also provide technical assistance to businesses in preparing feasibility studies for financing packages. This could be performed by a subsidiary organization or a consulting company collaborating with the venture capital fund company. This service would be provided on a fee basis to entrepreneurs requiring the service.

Financial Support and Technical Assistance for Microenterprises and Small Scale Enterprises (Formal and Informal) in Makran

Much could be done to assist the development of both the formal and informal sector in Makran. Ways of tapping local financial resources should be investigated. The consultants were told that the branches of the NCB's in Turbat had the largest deposits in Balochistan. Whether the source of this money is from remittances from workers in the Gulf States or black market money from smuggling is not certain. One source said that much of this money is loaned on the informal market for up to 42% interest. A study of informal sources of finance for micro and small scale enterprises should be performed. In addition, further research should be performed on forms of technical assistance and training which could be effective in developing this sector. The Aga Khan Rural Support Program in the Northwest Frontier Province appears to have an approach of developing a "package of services" to assist microenterprises which may be worth looking into for application to Makran.[16] The venture capital fund company and leasing company established in Quetta could also provide the same financial and consultative services to Makran entrepreneurs.

One comment which was mentioned more than once during interviews is that the impact of tribalism in Makran is less than in other parts of Balochistan due to the exposure of many Makranis to other parts of the world and the breakdown of the societal structure in Makran. This aspect is viewed as being helpful in getting private investment established, since there does not seem to be the same antipathy toward the private sector and development in Makran as in some other parts of Balochistan.

Studies of microenterprise development around the world have shown that women are often highly involved at this level of enterprise. The potential for a substantial level of women's involvement in income-generating private sector activities should also be investigated.

Other Potential Private Investment Ideas

A number of ideas for private investment in Balochistan were suggested during the course of this consultancy which deserve mention here but require further investigation. The following list of ideas is given with only a brief description of the potential activity and constraints:

1. Mining

   Although much is made of the mineral deposits in Balochistan, the potential for development appears to be limited - large scale projects run into roadblocks with tribal leaders and small scale mining is limited. The Economics Officer at the U. S. Embassy mentioned that he knows of a Pakistani-American who is mining chromite in Balochistan with the help of a local relative and claims to be doing well. The coal mining industry in Balochistan produces mainly a low grade coal used for the brick kilns in Sind and Punjab. The demand for this coal slacks off during the Monsoons when construction slows down.

2. Power Plants

   The central government has encouraged private sector development of power plants. The Hub River Power Plant Project is the first major project of this type. It is running into problems due to resistance by the Balochistan provincial government. Two projects which the USAID Energy Office mentioned have been proposed by American firms are gas-fired power generators near Uch (the border area between Balochistan and Sind which has extensive natural gas deposits) and a windmill power generating project along the Makran coast.

3. Small Scale Cement Plant in Makran

This was suggested by a number of sources, including a contractor in Turbat. The key question is the availability of power (which should be available from the Pasni power plant when completed) and local quality limestone to use in manufacturing.

4. Increased Production of Limes in Makran

Although many Makran farmers have been cutting down their lime trees, some educated sources believe that the completion of the Turbat - Bela road will make more lime production feasible for domestic markets via Karachi. Another suggested the possibility of dried limes for export for processed foods.

5. Modern Well-Digging Contractors in Makran

According to BALAD advisors, the current technology used by well-diggers in Makran is very primitive. There appears to be scope for private investment in modern well-digging equipment.

6. Coastal Ferry for the Makran Coast

Although this would seem to have limited utility once the road between Turbat and Bela is completed, the person who suggested it has worked on the Gwadar Harbor Project and believes that it would still be feasible even with the road completed, due to the volume of business along the coast.

7. Tanning of Hides

Discussions with a number of sources indicated that this would not be a feasible private investment in Balochistan due to the necessity for large amounts of water for tanning hides and the shortage thereof in Balochistan.

8 Raising of Livestock in Makran

Sources indicated that this is not a feasible private investment in Makran due to the requirement of water for fodder which can be put to better use in Makran.

RECOMMENDATIONS FOR A USAID STRATEGY

TO PROMOTE PRIVATE INVESTMENT IN BALOCHISTAN

The recommendations made in this section of the report address how USAID can implement or assist in the implementation of some of the actions described in the previous chapter.

Quetta-Based Interventions

1. USAID should assist in the establishment of the venture capital fund company and the private leasing company in Quetta. It appears that USAID could provide this assistance initially through its Small Business Loan Portfolio Guarantee Program, administered by the Bureau for Private Enterprise in Washington, D.C. In addition, USAID might provide assistance using the International Executive Service Corps (IESC) to get the companies established. USAID should invite proposals from interested parties on how they would establish these companies and, particularly, how they would generate local investment in and through these companies.

2. Consideration should be given to expanding the contracts of the SRD Research Group Inc. and RONCO to study and/or develop the potential for new export-oriented high value fruit crops in Balochistan. RONCO has been working in Pakistan for some time now and knows the national market. A look at Balochistan from their national perspective could be valuable. The SRD Research Group has just begun to field its team for their work in Pakistan. It would be a good time to expand their work now, if it is believed they could be of value in this area.

3. USAID should consider possible technical assistance to the Chamber of Commerce and Industry in Quetta and the Chamber of Agriculture in Balochistan. They represent two of the very limited number of private sector support organizations in Balochistan and ways of assisting them should be explored.

Makran-Based Interventions

4. Since the extension of the activities of the BALAD project are currently under consideration, USAID should consider which elements of this strategy might be implemented through those contracts and budget sufficient funds to meet possible research, technical assistance and interventions in the current project. Judgements should be made as to which actions are feasible during the extension of current efforts and which actions should be implemented during the next phase of the BALAD project.

5. Exploration of potential **markets for dates** and other fruits grown in the Makran Division should be undertaken using the agronomist in the BALAD project, SRD Research Group and RONCO or a combination of the three.

6. Other potential small scale agribusiness ventures and activities should be identified by the BALAD staff.

7. A short-term consultant should be brought in by USAID to do a comprehensive study of the fisheries development along the coast and design a strategy for enhancing private sector investment in that industry.

8. A substantial research effort should be mounted to study the possibilities for development of micro and small scale enterprises (formal & informal) in Makran. This subject is currently receiving a lot of attention by various donors, including USAID, the World Bank, the ADB, and a number of European donors, notably the Dutch and West Germans. A wealth of information exists on the subject. The U. S. Congress has earmarked that $75 million be spent by USAID annually on loans to microenterprises of less than $300 each. The USAID Bureau for Private Enterprise has a program entitled GEMINI which has funds available for studies of micro and small scale enterprises around the world. It may be possible to buy-in to some activities under their program.

   The Government of Pakistan has demonstrated a commitment to develop small scale enterprises and USAID should explore ways that its efforts in this direction may complement current efforts of the World Bank and the ADB in Pakistan.

   USAID should explore possible interventions which might allow cooperation with the U. S. Peace Corps to use Peace Corps Volunteers in its efforts to develop small scale enterprises. USAID has funded the development of micro and small scale enterprise programs for the Peace Corps around the world (MEDAP). This effort could be built upon in Pakistan.

9. USAID should assist in establishing a Chamber of Commerce and Industry in Turbat to promote private sector activities there and to be a partner in designing possible interventions to assist the private sector. Good! Step one

In conclusion, it is hoped that this report has provided a basic understanding of the private sector investment climate in Balochistan and has given some positive directions to USAID on how to address this issue in its future project activities in Balochistan.

NOTES

1. Hesser, Leon, "Pakistan - Analysis of Corporate Sector Constraints in Agriculture: Assessment of the Existing National Agribusiness Environment - (Draft) Findings and Conclusions," RONCO/USAID, March 1990, p. 15.

2. All data on foreign investment is from Foreign Liabilities & Assets and Foreign Investment in Pakistan, State Bank of Pakistan, 1987.

3. U. S. Embassy/Islamabad, "Investment Climate Statement - Pakistan," U. S. Embassy/Economic Office, June 15, 1990, p. 6.

4. Financial & Management Services Ltd., "Industrial Development Opportunities for Baluchistan," Pakistan Banking Council, July 1989, p. 11.

5. Islam, Ghayurul, "Rural Industrial Policy - Tax Incentives Alone May Not Work," Balochistan Times, June 19, 1990, p. 4.

6. Husain, Tariq, "Pakistan Credit and Support Services for Micro Enterprises," World Bank, April 1989, p. 6.

7. Asian Development Bank, "Appraisal of the 4th Development Financing Loan Project in Pakistan," ADB, November 1989, p. 6.

8. Ibid., p. 9.

9. Financial & Management Services Ltd., op. cit., p. 42.

10. Buzdar, Nek, Socio-Economic Survey of the Makran Division of Baluchistan, USAID, July 1987, p. 10.

11. Economic Adviser's Wing, Finance Division, Economic Survey, 1989-1990, Gov't of Pakistan, 1990, p. 21 (Statistical Appendix).

12. Hawaiian Agronomics Inc., "Fruit and Vegetables Storage and Marketing Development Project: Feasibility Study," Gov't of Pakistan/Asian Development Bank, February 1986, (Annexes) P. B-120.

13. USAID, "Project Paper - Pakistan: Baluchistan Area Development (BALAD) (391-0479), USAID, July 1984, Annex 15, Table 7.

14. Ministry of Food, Agriculture & Cooperatives, Agricultural Statistics of Pakistan 1988-89, Gov't of Pakistan, Dec. 1989, p. 200.

15. Husain, Tariq, op. cit.

16. Ibid., p. 37.

LIST OF ANNEXES

1. Scope of work
2. Workplan
3. List of persons contacted/facilities visited
4. Bibliography
5. Investment Climate Statement - Pakistan
6. Description of informal systems of credit for microenterprises

STATEMENT OF WORK

I. Objective

To undertake an assessment of the private sector investment climate in the Balochistan Province of Pakistan, in general, and the Makran Division, in particular.

II. Background

The Government of Pakistan (GOP) formulated a Special Development Plan for the Balochistan Province in August 1980 to attract foreign donor support to participate in the economic development of the area. The Balochistan Area Development Project (BALAD) is USAID's principal effort to support development in Balochistan. The on-going BALAD project is due to be completed in December 1990. A proposed BALAD-II project is under consideration to strengthen the activities started under BALAD-I.

The Project Committee, in its recent review, has recommended that the Mission conduct analyses to identify potential open market opportunities to be pursued under the proposed BALAD-II Project Paper. The analyses require an in-depth assessment of the private sector investment climate in Balochistan, in general, and Makran, in particular.

The following scope of work takes into account the peculiarities of Makran and Balochistan and recognizes the current limitations on private investment in those areas due to the harsh physical environment, political and security concerns, and lack of infrastructure for development. It attempts to provide a means to address the need for an overall assessment for the purposes of the Project Paper for BALAD-II, based on a limited level of effort and utilizing existing current secondary research to a high degree. However, it also provides for more extensive efforts to investigate potential investment opportunities and to perform primary research to analyze economic and financial policy issues as a part of a longer, concerted effort during the implementation of the BALAD-II Project.

III. Scope of Work

A. Phase I

This phase shall consist of a general overview of the private sector investment climate in Balochistan and Makran. It shall describe and analyze the following factors:

1. Political stability and business confidence including an analysis of these factors for both Pakistani and foreign investors. The contractor should also present a sensitivity analysis of investor confidence in investment

in Balochistan based on a limited survey of local and foreign business and banking executives in Pakistan.

2. **Industrial development** policy reviewing the GOP's policies for industrial development including the legal and regulatory framework for private investment in Pakistan, in general and, Balochistan, in particular. Topics to be covered include the investment code, foreign exchange policies and repatriation of earnings, taxation, customs duties on raw materials and finished products, and other relevant government policies which either encourage or discourage private investment.

3. Credit and financial policies including a description of credit sources and availability for investment in Balochistan, credit terms and financial constraints on investments. The contractor should also provide a brief review of provincial sources of finance for investment in Makran and Balochistan with recommendations for further study.

4. Labor relations including national and provincial labor laws and policies; it should also analyze labor availability, rates of compensation, and political issues relative to labor in Makran.

5. Transportation reviewing the current modes and volume of transportation for people and goods to and from Makran, as well as types of goods currently transported, and the potential impact of the completion of the Bela-Awaran-Turbat road.

6. Current private investment in Balochistan and Makran. This shall present an overview of current private sector industries operating in Makran, including types of industries and size of operations, distribution channels, financial participation by companies outside Makran, and restraints on private investment due to unfair public sector competition or government policies. The contractor shall present available baseline data on this topic and recommend further research to collect additional baseline data, as necessary.

7. Potential for increased private investment in Makran reviewing geographical, topographical, climatic and societal, and infrastructure constraints and presenting potential investment opportunities. This analysis should also review the potential effects of current foreign donor projects in Makran and Balochistan to improve the investment climate there.

8. Comparative analysis of private investment potential in Makran relative to other parts of Balochistan and to Sind. This should include an analysis of markets in Balochistan, Sind and Iran for current and potential

exports of agricultural produce, fish, and other industrial products.

9. Any other factors which impact upon private investment in Makran and Balochistan.

B. Phase II

This phase shall continue the process and build upon the research performed during Phase I, but will involve in-depth investigations and analyses of the following elements.

1. Appraisal of key potential private investment projects in Makran including prospects for success, potential sources of finance, availability of resources, constraints, timetables for implementation and potential rates of return.

2. Informal sources of finance for private investment in Makran including a survey of various sources of income for residents of Makran and Balochistan.

3. Existing trade links between Balochistan, Iran and Afghanistan and their effect upon trade in Makran. The contractor should analyze how GOP policies affect this trade.

4. Linkages between Makran and the Gulf States reviewing the potential for encouraging investment by either citizens of those states or by Makrani's working in the Gulf.

5. Potential for investment by U.S. investors based upon the analyses performed under #1 above with consideration of constraints on assistance by USAID for certain types of productive investments.

6. Recommendations for Policy Changes by the GOP and Balochistan Provincial Government to improve the private investment climate in Makran and Balochistan.

7. Other Research recommended by the consultants or USAID during Phase I.

IV. Level of Effort

A. Phase I

Phase I shall require the services of two senior expatriate consultants for 30 workdays; 1 day shall spent in briefings in Washington, DC, 4 days for travel, and 25 days performing the research and analysis in Pakistan and writing the report. A senior local consultant shall be retained by the Mission to participate in the collection and analysis of data for 25 days in Pakistan.

The consultants shall be based in Islamabad, but will travel to Quetta, Makran and Karachi to interview government and private officials there. A partial listing of documents to be reviewed is found in Annex 1.

B. Phase II

Phase II shall be dependent upon approval of the scope of work for that phase by the Project Committee which reviews the Project Paper for BALAD-II. Upon approval, Phase II shall require the services of 2 senior expatriate consultants for a total of 18 months (1 for 12 months and a second for 6 months). It shall also require 1 senior local consultant for 12 months to participate in research, interviews and analysis. 3 additional local consultants shall be required to interview respondents in Makran and other parts of Balochistan for a total of 6 months (2 months each). All local consultants shall be supervised by the Contractor.

The two expatriate consultants and senior local consultant shall be based either in Islamabad or Karachi, but shall travel extensively to Quetta and Makran and to other areas as necessary to conduct interviews and supervise the local interviewers. The three local interviewers shall be based in Makran.

V. Qualifications

A. Phase I

One expatriate consultant shall be an expert in private sector development in developing countries with experience in market research. The other expatriate shall be an expert in investment finance and government regulation of private industries in developing countries. Both should have experience working in Pakistan. The local consultant should have held a senior position either in government or private industry and be familiar with private investment in Pakistan, local and export markets for Pakistani products and government regulation of industry. The local consultant should also be Baloch or have experience working in Balochistan.

B. Phase II

The 12-month expatriate consultant should be an expert in private investment in developing countries and, preferably, experience working in Pakistan. The 6-month consultant should be an expert in agricultural development and marketing of agricultural products. Both should have at least 5 years experience working in developing countries.

The local senior consultant should have the same qualifications as the local consultant during Phase I. It would be preferable to have the same person in both phases to provide continuity. The 3 local interviewers should be Makrani's, have a university degree and be familiar with interviewing techniques.

VI. Reporting

A. Phase I

The contractor shall prepare and submit a workplan to O/ARD for approval within 5 days of the arrival of the consultants in Pakistan.

The contractor shall present a draft report to O/ARD at least 2 days prior to departure. The consultants shall attend a debriefing on their consultancy the day before departure from Pakistan.

A final report shall be submitted by the contractor within 2 weeks of the departure of the consultants, incorporating any comments of the Mission at the debriefing session.

B. Phase II

The contractor shall deliver reports on each of the 7 elements listed under the scope of work for Phase II according to a schedule to be determined and agreed upon by the consultants and O/ARD. This schedule shall be part of a workplan submitted by the contractor within 1 month of the arrival of the first expatriate consultant in Pakistan.

VII. Technical Direction

(Both Phase I and II)

The contractor will work under the technical direction of the Chief, Office of Agriculture and Rural Development (O/ARD) or his designee.

ANNEX 1

PARTIAL LIST OF DOCUMENTS FOR REVIEW BY PHASE I TEAM

Note: This is a partial list of documents which should provide considerable assistance to the consultants for Phase I of the consultancy. There appears to be a good deal of recent research available which reviews the national climate for public investment, particularly in agro-industries. Good studies at the provincial level are more difficult to find. Hence the need to make a more specific study of Balochistan for the purposes of the BALAD-II Project. However, one study was identified which was published in July 1988 titled "Industrial Development Opportunities for Baluchistan," which was written for the Pakistan Banking Council and presents good information which the Phase I team should be able to build upon. That study is cited below, amongst others.

1. "Project Paper, Baluchistan Area Development (BALAD)," USAID, July 1984

2. TvT Associates, "Interim Evaluation of the Baluchistan Area Development Project," USAID, December 1987

3. Financial and Management Services (Pvt) Ltd., "Industrial Development Opportunities for Baluchistan," Pakistan Banking Council, July 1988

4. Buzdar, Nek, "Socio-Economic Survey of the Makran Division of Baluchistan," USAID, July 1987.

5. Upreti, Bedh P., "Agriculture and Society in Makran," USAID, March 1989.

6. Bashir, Jawaid, "Agrobased Industries - Fish Industry of Balochistan, Director/Fisheries - Balochistan, (Undated, but with 1987 data)

7. Various reports by Chemonics (Food Security Management, EAN) and RONCO (Ag Sector Support Program) dealing with constraints and opportunities for private sector investment at the national level and focusing on agro-industries

8. Produce Studies Ltd., "Pakistan: Fruit and Vegetable Export Marketing Study," (Draft) ADB, December 1989

9. Ministry of Commerce, "Trade Policy 1987-89, Vol. II Export Policy," Government of Pakistan, 1989.

10. Louis Berger, Inc. and Robert R. Nathan Associates, Profile of Private Sector Cross-Border Trade Between Afghanistan and Pakistan," USAID, (Phase I report - Aug. 1989, Phase II draft report expected in April 1990.)

ANNEX 2

WORKPLAN

PRIVATE SECTOR INVESTMENT CLIMATE ASSESSMENT

BALOCHISTAN/MAKRAN DIVISION

Monday, June 11

Team arrives in Islamabad in morning
Orientation meetings with USAID in afternoon

Tuesday - Thursday, June 12 - 14

Meetings with USAID officials
Meetings with Chemonics, RONCO and others
Collection and review of relevant documents
Logistical arrangements for travel to Balochistan and Karachi
Submission of workplan to USAID

Friday, June 15

Travel to Quetta

Saturday - Tuesday, June 16 - 19

Meetings with USAID staff, government officials, financing institutions, and private sector representatives in Quetta area

Wednesday, June 20

Travel to Turbat

Thursday, June 21

Visits to industries and agricultural sites in Turbat and Posni areas
Meetings with BALAD project staff, local government officials, and private sector representatives

Friday, June 22

Morning: Continuation of meetings above
Afternoon: Travel to Karachi

Saturday - Monday, June 23 - 25

Meetings with banking, government, local marketing organizations, and local businesses in Karachi

Monday, June 25

Evening: Travel to Islamabad

Tuesday - Thursday, June 26 - 28

Further meetings in Islamabad & review of documents

Friday, June 29 - Friday, July 6

Preparation of draft report

Saturday, July 7

Submission of draft report to USAID

Sunday, July 8

Debriefing of LBI team and discussion of draft report
Evening: Team departs Pakistan for USA

July 9 - 23

Preparation of final report in Washington, DC with incorporation of comments from USAID/Pakistan (if necessary) (Estimated time 3 Person-Days)
Send final report to USAID/Pakistan by courier

ANNEX 3

LIST OF PERSONS CONTACTED/FACILITIES VISITED

USAID
Hans P. Peterson, ARD
John Tucker, Acting Chief, RDD, ARD
Richard Goldman, Chief, Private Enterprise Office
Asif Bhattee,Program Specialist, ARD
A. Karim Nayani, Project Officer, BALAD Project, ARD
Sardar Yusuf, Program Assistant, BALAD Project, ARD
Christine Sheckler, Program Manager, ARD
Ahsan Tayyab, Agribusiness Specialist, ARD
C. David Esch, Human Resources Development Officer
John L. Swift, Chief, Power Div., Office of Energy
Asarullah, Program Mgr., Office of Energy & Dev.
Anjum Ahmad, Chief, Energy Planning & Resources Div.
M. Fayaz Nasim, Trade and Investment Specialist

U. S. EMBASSY
Lawrence Benedict, Counselor for Economic Affairs

BALOCHISTAN PROVINCIAL GOVERNMENT
S. R. Poonegar, Chief Secretary
Ata M Jafar, Additional Secretary - Development
Saadullah Marri, Secretary of Industries, Commerce & Mineral Dev.
Anwer Zaman Khan, Secretary of Livestock
Javeed Bashir, Director of Fisheries
Mubasher Ahmed Zafar, Director of Industry

BALOCHISTAN DEVELOPMENT AUTHORITY
Yunus Mandokhel, Chairman, Balochistan Development Authority
Mohammad Amin Farooqi, Gen. Mgr. Planning & Mines

BALOCHISTAN PROVINCIAL ASSEMBLY
Akram Baloch, Member of Provincial Assembly from Makran
Dr. Malik, " "

PAKISTAN NATIONAL ASSEMBLY
Manzoor Gichki, Member of National Assembly from Makran

ARID ZONE RESEARCH INSTITUTE/ICARDA - QUETTA
Hassan Raza, Deputy Director
Alan Alister, Advisor
Rodriguez Abelardo, Advisor

BALOCHISTAN BUSINESSPERSONS
Saifullah Khan Paracha, Managing Dir., Habibullah Mines, former Provincial Minister of 5 portfolios during 70's & 80's and former President of the Federation of Pakistan Chambers of Commerce

BALOCHISTAN CHAMBER OF AGRICULTURE
Nawab Mohammad Raisani, President

QUETTA CHAMBER OF COMMERCE
Executive Committee - including:
Mir Afzal Khan, President
A. D. Ahmed, Seiko Traders
Khurshid Jogezai
Asad Ali, Contractor & Trader
Fazal-ur-Rehman Dittu, Chairman, Dittu Group of Industries
Abdul Hussain, Managing Partner, Compuaids, Essajee & Son
Khalifa Tahir Ahmad, Gen. Mgr., Shahnawaz Ltd.

AGRICULTURAL DEVELOPMENT BANK OF PAKISTAN
Chaudry Ahmad Saeed, Chairman
Mir Ali Mohammed Jamali, Director, Balochistan Provincial Office
Faiz Ahmed Khan, Regional Manager

BANKERS EQUITY, LTD.
I. H. Shamsi, Senior Exec. VP
Ashfaq Ali Quettawalla, Exec. VP
Shahid Mahboob, Asst. VP & Mgr., Quetta Office

NATIONAL DEVELOPMENT FINANCE CORPORATION
Ghulam Hussain Nadir, Mgr., Quetta Office

REGIONAL DEVELOPMENT FINANCE CORPORATION
Iftikhar A. Jogezai, Asst. VP, Quetta Office
Anwar S. Hashmi, Manager, Quetta Office

INDUSTRIAL DEVELOPMENT BANK OF PAKISTAN
Syed Zahir Abbas Zaidi, Chief Mgr., Quetta Office

RONCO/ACSCA
Leon Hesser, Chief of Party
George Metcalfe, Corporate Agribusiness Specialist
Scott Eubanks, Agricultural Economist

CHEMONICS/EAN
Forrest Walters, Team Leader
Akhtar Mahmood, Senior EAN advisor

USAID DEVELOPMENT SUPPORT TRAINING PROJECT
Peter Boynton, VP, Academy for Educational Development, Inc.
Larry Kirkhart, Dir., Management Training

SRD RESEARCH & DEVELOPMENT GROUPS
Samuel R. Daines, President

LBII/BALAD PROJECT
James Schoof, Team Leader
Dan Bradbury, Agronomist

FINANCIAL & MANAGEMENT SERVICES (Pvt.) Ltd.
M. R. Khan, Chairman (former Chairman of Pakistan Banking Council)
Shezi Naqvi, Managing Dir.

DEVELOPMENT RESEARCH & MANAGEMENT SERVICES
Tariq Hussein, Director
Maliha Hussein, Director

U.S. PEACE CORPS
Mark Parkison, Associate Peace Corps Director

TURBAT AREA
Mir Habib Ullah Gichki, Contractor
Inspection of date processing plant operated by Shah & Sons
Interviews with various micro-entrepreneurs in Turbat

POSNI AREA
Moulabux Baloch, Asst. Dir., Directorate of Fisheries
Inspection of port facilities, public sector fish curing facility and ice-making plant and boat building/repair workshop, private sector fish curing facility, and private fishmeal plant
Karim Bux, owner/investor in Posni fishmeal plant

KARACHI AREA
Habib Rahman, Business consultant and former Chairman of Unilever Pakistan
Masood A. Burney, Chief Exec., Chang Fisheries Industries (Pvt.) Ltd. & former Balochistan Dir. of Fisheries
M. Yusuf A. Rehman, Proprietor, Kathiawar Trading Company, and Chairman of various exporter associations
M. M. Irani, Specialist in dried fruits and nuts and former buyer for date processing companies and exporters
Qamar-Us-Salam Khan, Business consultant and former Dir. Gen. of Supply and Prices/Sind Prov. Gov't.
Shakirullah Durrani, Dir./Owner, Orix Leasing Pakistan Ltd.
Humayun Murad, Managing Dir., Orix Leasing Pakistan Ltd.
Visited Karachi fruit and vegetable market

ANNEX 4

BIBLIOGRAPHY

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ANNEX-5

INVESTMENT CLIMATE STATEMENT

PAKISTAN

JUNE 15, 1990

(A) ECONOMIC OVERVIEW

Pakistan is one of the world's poorer countries, with annual per capita income of about $390. The population, now at approximately 109 million, continues to grow at over 3 percent per year. The relative prosperity of the industrialized regions around Karachi and Lahore and the rich farming areas of the Punjab contrast sharply with semi-arid Balochistan and the mountainous Northwest Frontier.

Pakistan historically has experienced uneven development: rapid industrial growth in the 1960s was followed by stagnation under the socialist policies of former Prime Minister Zulfiqar A. Bhutto. Since 1977, however, real gross domestic product (GDP) growth has averaged an impressive 6.7 percent per year. GDP is expected to grow at 5.2 percent in Pakistan fiscal year (PFY) 1990, a slight rebound after a 4.8 percent growth rate the previous year. (The Pakistani fiscal year runs from July through June.) The share of agriculture in GDP has declined from 53 percent in 1950 to 23 percent in PFY 1990. Conversely, manufacturing now contributes over 20 percent to GDP (compared to 8 percent in 1950).

Federal budget deficits are a source of concern as large public borrowing has contributed to high interest rates and inflation. The budget presented by the Bhutto government for PFY 1991 contains a number of measures -- including additional taxes and improved tax administration procedures -- to increase revenues. Other steps intended to help reduce the deficit such as capping federal funding for provincial expenditures were implemented the previous year. The PFY 90 deficit target of 6.3 percent of GDP target will be hard to achieve due to an increase in debt servicing costs and increased military expenditures in response to heightened tensions on the Indo-Pakistan border. Pakistan is currently in the midst of a multi-year economic structural adjustment program aimed at deregulating the economy and promoting private sector-led growth.

The government, beset by the opposition, lacks the political strength to address its many economic challenges in a rapid manner. Moreover, continued ethnic violence in the industrial cities of Karachi and Hyderabad, a tense relationship with India over Kashmir and uncertainties regarding Afghanistan have not permitted the government to devote enough attention to economic issues.

SOURCE: Economics Officer, U.S. Embassy Islamabad.

The Bhutto government revised the Seventh Five-Year Plan -- which runs from PFY 1989 through 1994 -- to devote more resources to the long-neglected areas of health care and education, and to promote private sector development. To this end, the Five-Year Plan calls for Rs. 87.5 billion (about $3.977 billion in current rupees) in private sector investment as against Rs. 9 billion ($409 million) in the public sector. This Plan and the Annual Development Program which flows from it are key elements in setting priorities for government development expenditures and policies.

Agriculture: Agriculture employs 50 percent of the labor force in Pakistan, earns approximately 65 percent of export revenues, and contributes 26 percent to GDP. Relying on the world's largest contiguous irrigation system, Pakistan grows cotton, rice, wheat, sugarcane, and a variety of fruits, vegetables, and other grains. Favorable weather and improved government policies have spurred agricultural production during the past 10 years. Pakistan is a net exporter of agricultural based commodities; it is self-sufficient in rice, cotton and some minor staple crops.

Pakistan has achieved a degree of self-sufficiency in wheat -- the staple food for most of the population -- but often supplements domestic production with imports. In PFY 1991, although the crop is expected to hit a record 14.4 - 14.7 million metric tons, large-scale imports (as much as 1.2 mmt) will be needed for the third year in a row. Wheat was de-rationed in March 1987. With the subsequent increase in the spread between the Government's procurement and resale prices, the subsidy for wheat has been reduced.

Cotton, rice, and wheat make up almost 70 percent of value-added in crop output. Two-thirds of Pakistan's cotton crop is exported as either cotton or increasingly as yarn or other textile products; 30% of the rice crop also is exported. Major agricultural imports are edible oil (70 percent of consumption), tea (100 percent of consumption), wheat, inedible tallow and dried milk powder.

Pakistan could be an overlooked source of raw materials and exotic agricultural products for the U.S. market. Possibilities for export include dried fruit products, herbs, and aromatic types of rice. Development of these crops for export will require extensive infrastructure development, transfer of technology and packaging and processing know-how. Pakistan is actively soliciting private sector investment in the agricultural processing sectors.

Manufacturing: Pakistan has developed a fairly broad industrial base after starting from scratch in 1947. Industry contributes about 20 percent to GDP and has become increasingly important to the country's development, particularly its export industries. Cotton textile production is Pakistan's single most important industry, accounting for 19 percent of manufacturing value-added, 28 percent of industrial employment, and over 20 percent of exports. Pakistan also has important cement, vegetable oil, fertilizer, sugar, steel, machinery, and food processing industries.

In PFY 1990, manufacturing grew at an estimated rate of 7.9 percent, a significant improvement over the previous year's 4 percent. Large and small-scale manufacturing increased 7.7 and 8.4 percent, respectively.

Nevertheless, there is serious cause for continued caution. Recent political and ethnic disturbances in Karachi and Hyderabad and infrastructural deficiencies are critical problems that have yet to be resolved. The recent ethnic violence, moreover, will have a more significant long-term impact as potential investors either look to less volatile regions of Pakistan (such as the Punjab), postpone their investment plans, or seek opportunities elsewhere. While a number of U.S. investors are proceeding with investment plans, several others put potential projects and plans on hold in early 1990.

Exclusively in private hands, Pakistan's small-scale industries are widely dispersed geographically and provide improved income distribution. They contribute 30 percent of manufacturing output and provide 80 percent of manufacturing employment.

The public sector's share in Pakistani industry has diminished in recent years. In PFY 1982, industry was divided evenly between the public and private sectors. By PFY 1989, private sector investment surpassed public sector investment for the first time since the wave of nationalizations in the mid-1970s. Large public sector enterprises include Pakistan Steel, State Engineering Corporation, National Fertilizer Corporation, State Cement Corporation, Pakistan Automobile Corporation, the Oil and Gas Development Corporation and State Petroleum Refining Corporation. The Bhutto government has announced its intention to privatize many public sector entities including banks and the Government recently began offering shares in selected state-owned companies to the public. Response to the first privatization program--sales of 10 percent of the share in Pakistan International Airline (PIA)--was extremely well received.

Although many domestically owned banks and large industries were nationalized in the 1970s, recently the GOP has encouraged the private sector to fuel economic growth through new investment. The government has created a Board of

Investment, chaired by the Prime Minister, to simplify and shorten the approval process for investment, both foreign and domestic. While the process has been streamlined, bureaucratic and infrastructure hurdles remain.

Energy. Two-thirds of Pakistan's energy requirements are met by commercial resources and one-third by sources such as firewood, charcoal, and cow dung. Oil meets about 40 percent of Pakistan's total commercial energy requirements. The remainder is met by natural gas (36 percent), hydroelectricity (17 percent), coal (5 percent), LPG (0.6 percent) and nuclear (0.3 percent). There has been an upsurge in oil and gas exploration and several new discoveries have been made. Numerous companies (including U.S.) have successfully negotiated petroleum exploration concessions. Total electrical generating capacity is estimated at approximately 7,000 MW. During the current five-year plan, the government plans to install additional electrical generating capacity of 6,558 MW, of which 2,168 MW will be hydroelectric and 4,390 thermal.

Commercial energy demand has grown at an annual compound rate of about 10 percent in the last five years; increased household consumption has constrained the share of energy available to the manufacturing sectors, with the result that the government must periodically resort to load shedding during peak periods. The annual amount of value-added lost due to load shedding is estimated at $500 million.

Although oil prices are not subsidized, diesel prices are among the lowest in the world for an oil importing country. In the summer of 1989, the government announced electricity price increases to bring rates more into line with actual costs. A similar price increase on oil and petroleum was introduced in the Spring 1990 and further increases (8.33%) in electricity prices were recently announced in the PFY 91 budget. Still, electricity prices -- at about three-fourths of long-run marginal costs -- are low by world standards.

The average domestic production of crude oil increased from 44,562 barrels per day (b/d) in PFY 1988 to 52,808 b/d in PFY 1990. The drilling success ratio improved from one-thirteenth during the Fifth Plan to one-half during the Sixth Plan. Recoverable reserves as of January 1990 are estimated at 108.9 million barrels.

Production of natural gas during PFY 1990 increased to almost 10 billion cubic meters, a 5.4 percent increase over the previous year. Recoverable natural gas reserves as of March 1990 were estimated at 500 billion cubic meters.

Hydropower supplies 49 percent of Pakistan's electricity. The Tarbela Dam has been expanded through projects supported by the World Bank and Asian Development Bank. The government is considering two additional major hydro projects, the Kalabagh and Basha Dams, as well as other smaller hydro facilities.

The private sector accounts for 85 percent of Pakistan's coal production. Coal reserves are estimated to be approximately 9 billion tons. During PFY 1989, reported coal production was 2.2 million tons. Unreported production was estimated at 0.9 million tons.

The government has taken steps to rationalize administered prices, promote conservation, encourage private sector exploration and reduce technical and administrative power losses. The public sector Water and Power Development Authority (WAPDA) that provides 80.3 percent of the nation's electricity, floated its first public bond issue during PFY 1988, a second in PFY 1989, and a third in PFY 1990, with the first two raising approximately $470 million.

The government has taken a major policy initiative in the field of power generation by issuing letters of intent for five private sector for power projects. These projects are in various stages of implementation. With a high growth in energy demand, Pakistan will have to aggressively promote energy development and initiate an effective conservation program to avoid persistent energy shortages and blackouts.

<u>Inflation</u>: According to official government statistics, inflation in PFY 1990 decreased to a respectable rate of 5.7 percent, down from 10.4 percent the previous year but still above government targets. The wholesale price index was up approximately 7.3 percent, slightly lower than last year's level of 9.5 percent. The public perception, however, is that official statistics tend to underestimate actual inflation. Housing costs -- which have risen sharply in major cities -- will be given more weight in the new consumer price index that will be introduced this fiscal year.

<u>Balance of Payments</u>: According to official statistics, the current account deficit in fiscal year 1990 declined, with a projected reduction of approximately $200 million to $1.7 billion (slightly less than 5 percent of GNP). This recovery was led by the growth in textile exports which increased by over 20 percent and was the result of an aggressive exchange rate policy. Increased debt-service payments and higher than expected defense spending, however, continue to be significant problems. Foreign exchange reserves at the end of calendar year 1989 were estimated at $470 million, or roughly 4 weeks of imports. PFY 90 exports are expected to be up by 6.1 percent and imports down by 0.1 percent.

Overall, the balance-of-payments position in PFY 1990 improved as a result of export growth and a decline in imports. Pakistan, however, is currently highly dependent on a small number of exports: raw cotton, cotton yarn and textile items account for 45 percent of export earnings. The government attaches high priority to diversifying the export base.

(B) GOVERNMENT ATTITUDE TOWARD FOREIGN PRIVATE INVESTMENT:

Since 1977, the GOP has taken numerous steps to revive the private sector and attract private foreign capital. Its objective has been to focus industrialization efforts on export-oriented, capital intensive and high technology industries. Prime Minister Benazir Bhutto has placed increasing emphasis on more foreign investment, campaigning actively for increased foreign investment in Pakistan by aggressively courting investors during her trips abroad, including a visit to the United States in June 1989. This high-level support for foreign investment has resulted in a reduction of bureaucratic obstacles facing investors wishing to establish a business in Pakistan. While progress has been made, significant hurdles remain.

Foreign investors remain cautious about investments in Pakistan due to the perceived level of government control, a history of cumbersome investment sanctioning procedures, high effective corporate tax rates, a strict indigenization policy, and weak infrastructure. There also is a perception of political risk in Pakistan, given the political uncertainties associated with the war in neighboring Afghanistan and the periodic tensions with India. The continuing civil disturbances in the Sindh and their effect on business activities also reinforce this impression. Businessmen in Karachi have reported, however, that the disturbances there have not had a serious impact on profitability.

Foreign private investment is governed by the Foreign Private Investment (Promotion and Protection) Act of 1976 administered by the Ministry of Industries. This act provides security against expropriation and adequate compensation for acquisitions. It also guarantees to foreign investors the right to repatriate funds up to the amount of the original investment, profits, and any additional amount resulting from re-invested profits or appreciation of the investment. Foreign nationals employed in industrial undertakings having foreign private investment may make remittances of their monthly salaries or (at the end of their tenure) of their accrued savings subject to regulations or orders issued by the Federal Government or the State (Central) Bank of Pakistan. National treatment with respect to laws, rules, and regulations relating to import and export of goods is provided. In addition, the U.S.-Pakistan Treaty of Friendship and Commerce provides for national treatment of U.S. businesspeople in other areas. There is also a bilateral tax treaty which protects against double taxation.

(C) RULES AND REGULATIONS COVERING INVESTMENT:

The Bhutto government took office with the avowed intention to make it easier for foreign investors to invest in Pakistan. While definite progress has been made, room for improvement remains. Procedures for foreign investors have been stream-lined, and most potential foreign investors no longer need government approval. All potential investors, both foreign and domestic, are to be treated equally.

The Investment Promotion Bureau (IPB)

Should a potential investor have any questions regarding investment procedures, inquiries should be addressed to the Investment Promotion Bureau (IPB). The IPB's new role is three fold: to promote investment, review applications and feasibility studies, and assist sanctioned investors obtain land, utility hookups, etc.

The Board of Investment (BOI)

Government sanction is now required only for those investors proposing investment of more than Rs. one billion (approximately $50 million), investment located in a "specified area", and investments involving a policy precedent, usually interpreted as an incentive or concession package beyond the standard package prescribed by the government. In such cases, investors must file an application and feasibility study with the Investment Promotion Bureau (IPB). The IPB reviews the application before passing it to the Board of Investment (BOI) along with a summary. The BOI, chaired by the Prime Minister, makes all decisions on investment sanctioning. The BOI must issue a decision on sanctioning within 60 days. Permanent members of the BOI include the Prime Minister, the Ministers of Petroleum, Industry and Communication, the Director of the Water and Power Development Authority, the Deputy Chairman of the Planning Commission, the Chairman of the State Bank and other Federal Ministers.

The "Specified List" consists of arms and ammunition, security printing, currency and mint, high explosives, radioactive substances, alcohol and foreign brand beverages, automobiles, tractors and farm machinery, and petroleum blending plants.

Committee on Investment

Once sanction has been obtained, if required, procedures to register a company and file the necessary paper-work can be time consuming. While the establishment of a "one window" facility is under active consideration, none exists at present. The Committee on Investment (COI) under the Ministry of Industries is charged with assisting all investors file the proper forms with the proper offices as well as to help arrange for power, gas, communications, water and sewage, etc. The COI should be thought of as a "general consultant" and/or facilitator for investors. The IPB monitors oversees the COI to ensure that it is working effectively.

Foreign private investment is prohibited in agricultural land, forestry, irrigation, real estate (including land, housing and commercial office buildings), radioactive minerals, insurance and health.

Sanctioning or Approval Procedures. Once an investment has been sanctioned or the determination has been made that a sanction is not necessary, the following steps must be taken.

1) Register under the Companies Act 1984. Would-be companies must submit a memorandum (or constitution) of the company and Articles of Association to the Registrar of Companies in order to obtain a certificate of incorporation.

   There are two kinds of limited liability company in Pakistan, public and private. Private companies are restricted in their right to transfer shares; the number of shareholders is restricted to 50, excluding employees; and public sales of stock and debentures are prohibited. Public companies (for tax purposes those whose stock is traded publicly) have no such limitations, although they must publish financial information.

2) Obtain the approval of the Controller of Capital Issues (Ministry of Finance) to issue shares.

3) For foreign companies whose investment is more than Rs. one billion, sanction from the BOI authorizes repatriation by the State Bank. Once sanctioned, such investors need only apply to the State Bank to set up the repatriation mechanism. Investors not needing sanction may go directly to the State Bank. (See Repatriation below for further discussion.) Obtain the approval of State Bank for the transfer of foreign equity and confirmation of guarantees received from the Government.

4) Issue the prospectus and allot the capital (for public limited companies only).

5) Projects which do not require government sanction can apply directly to the Chief Controller, Imports & Exports (CCI&E) for a license to import plant and machinery.

Undertakings which require government sanction must apply for their import license through the IPB after obtaining the sanction. The IPB is under strict instructions to deliver the application to the CCI&E immediately. (The CCI&E is supposed to issue the license within 24 hours. Some investors have reported that this approval was often the most difficult to obtain.)

6) Foreign nationals employed in the undertaking must be registered with the IPB. Although registration is required, there are no restrictions on the employment of foreign nationals.

7) To import raw materials, an industrial undertaking must also be registered with the Regional Imports and Exports office.

Experience suggests that a knowledgeable local partner or representative can assist in this process. Personal contacts are essential in pursuing an investment decision in Pakistan. A U.S. company would definitely benefit from establishing a small office headed by an American to monitor the process.

Rules on Acquisition, Takeover, and Reinvestment. No special procedures exist to regulate or deter the takeover of an existing firm. In cases involving both Pakistani firms and those firms in which foreigners hold a minority interest, the Companies Act of 1984 applies. No specific government approval is required. In cases where a majority-owned foreign firm in Pakistan is attempting to acquire a second firm, prior approval must be granted by the BOI if the company's worth is over Rs. one billion, the firm is involved in activity of the "specified list" or a "major policy decision is involved.". Such cases are treated as new investments.

Reinvested capital may be treated as an investment for the purpose of repatriation with the approval of the State Bank of Pakistan.

Repatriation of Earnings. Official GOP policy states that subject to the provisions of the Foreign Exchange Act of 1947:

"1. A foreign investor in an industrial undertaking established after September 1, 1954, may at any time repatriate in the currency of the country from which the investment originated:

a) foreign private investment to the extent of original investment;

b) profits earned on such investment; and

c) any additional amount resulting from the re-investment of profits or appreciation of capital investment.

2. A creditor of an industrial undertaking referred to in clause a) may repatriate foreign currency loans approved by the Federal Government and interest thereon in accordance with the terms and conditions of the said loan, provided that nothing in this section shall affect the terms of the permission to make such investment granted to a foreign investor before the commencement of this Act.

From time to time, the Government may question the amount of the profits being remitted abroad to ensure that sufficient earnings are being retained in-country and that the solvency and financial standing of the Pakistani operation is assured.

Repatriation is guaranteed by the Foreign Investment Act of 1976.

Federal Tax Treatment of Foreign-Owned Firms. Pakistan's treatment of tax on private foreign investment is defined in Article 8 of the Foreign Private Investment Act of 1976. This Article provides that industrial concerns involving private foreign capital are subject to the same treatment as that accorded to any investment made in similar circumstances by Pakistani investors, and are extended all the tax concessions admissible under the double taxation agreements which the Government has entered into with the country of origin of such capital. Foreign corporate investors are guaranteed the application of the same income tax rates as those levied on domestic companies.

1. Corporate tax is assessed on actual, as well as accrued, income. For companies in Pakistan, foreign earnings are also subject to taxation, with certain exceptions.

2. The standard corporate tax rate is 55 percent, made up of a 30 percent income tax and a 25 percent super tax, levied on net income excluding intercorporate dividends received and bonus shares issued. The corporate tax rate is uniform for all non-banking companies, but a system of super tax rebates allows public companies to be treated more favorably than private companies. Public companies qualify for a 5 percent rebate on super tax, and they are also granted a concessional tax rate on intercorporate dividends of 5 percent, as compared to the 15 percent levied on foreign concerns and 20 percent on private companies. (See also location- and industry-specific tax holidays discussed under Incentives.)

3. Super tax on the income of banking companies is charged at a rate of 30 percent on total income (excluding intercorporate dividends received by a public company or any bonus or bonus shares income).

4. The value of bonus shares issued is treated as income of the company and is taxed at the rate of 10 percent where the company is a public company and 15 percent in other cases.

5. Interest expense for loans from domestic lenders are not subject to withholding taxes. Interest paid to foreign lenders is subject to withholding tax unless the tax is reduced by the tax treaty or meets certain other conditions. Interest income is included in corporate income and is taxable.

6. The standard sales tax rate on most domestically produced goods is 12.5 percent. Excise taxes, which can be very high, are levied in many ways (e.g.: on the basis of installed capacity, annual production, ad valorem, etc.) and are usually placed on petroleum, tobacco, sugar, and vegetable products. Rates often change with the annual budget.

7. There is also a requirement for a 2 percent contribution of gross after tax income to a Workers' Welfare Fund for industrial firms which report gross income of at least Rs. 100,000 (just under $6,000 at current exchange rate). As in other countries, investors may also be taxed by provincial and municipal authorities.

Pricing Policy. While the GOP retains considerable powers to impose price controls on the economy, they have been moving away from centrally directed prices. Controls remain on drugs and pharmaceuticals, although Prime Minister Bhutto recently announced that those controls would be removed on a "step-by-step" basis. The controls are administered by the Ministry of Health, which suspects the foreign drug companies of exorbitant transfer pricing.

Industrial Finance. The banking system in Pakistan is comprised of the State Bank of Pakistan (the central bank), five nationalized commercial banks, 16 foreign commercial banks, specialized banks and financial institutions and cooperative banks. Four of the of the 16 foreign commercial banks in Pakistan are U.S. owned: American Express International Banking Corporation, Bank of America, Chase Manhattan and Citibank. The nationalized commercial banks, as the largest deposit institutions, are the main source of short and medium term credit for domestic investment. The latter banks include Allied Bank of Pakistan Ltd., Habib Bank Ltd., Muslim Commercial Bank Ltd., National Bank of Pakistan, and United Bank Ltd.

In addition, investors should be aware of the National Development Finance Corporation (NDFC), the Pakistan Industrial Credit and Investment Corporation (PICIC), the Industrial Development Bank of Pakistan (IDBP) and Banker's Equity Limited (BEL). NDFC is the largest development finance institution in Pakistan. At one time it provided financing exclusively for the public sector. Under the Sixth Five-Year Plan, however, it has shifted its emphasis. More than half of its long-term loans now go to the private sector. PICIC, on the other hand, promotes private investment in industry by 1) granting medium-long term loans denominated either in rupees or foreign currency for acquisition of fixed assets; 2) equity participation through ownership of shares and debentures; 3) underwriting public issues of shares and other securities; 4) assisting Pakistani entrepreneurs to obtain foreign investment; 5) assisting foreign investors to locate suitable investment opportunities in Pakistan; and 6) providing financial, technical and managerial advice to entrepreneurs. IDBP and BEL, similar to PICIC, provide medium and long-term credit for development of small and medium-sized projects.

Ten private investment banks have been sanctioned in the past year. As of June 1990, one has begun operating and four more are expected to launch operations in the near future. The remaining sanctionees have been told that they must be in operation by December 30 or their sanctions will be voided. So far one U.S. has bank, American Express, has been granted a sanction to participate as an investment bank.

Foreign owned companies are constrained when trying to raise loan capital locally by a centralized system of credit allocation and by onerous government regulations. Working capital financing can only be undertaken within limits specified by the State Bank, and these limits are inversely related to the proportion of foreign equity. While foreign investors are encouraged to raise foreign exchange loans abroad, the GOP nevertheless stipulates that such financing must conform to specific guidelines. In addition, the GOP's Controller of Capital Issues requires that the debt equity ratio for foreign investment not exceed 70:30 and that foreign investors make appropriate arrangements to meet their Rupee financing requirements through local equity.

Infrastructure Constraints. Acute infrastructure deficiencies in energy, water supply, transportation and telecommunications are viewed by foreign investors as a major constraint to industrial development in Pakistan. They are a major cause of project implementation delays and impose substantial costs on industrial production and efficiency.

Patents, Copyrights, and Royalties. The GOP has generally restricted contracts involving royalty and technical fee agreements to export oriented and/or capital goods industries. Current Pakistani law provides that if an agreement provides for the payment of a royalty or technical assistance fee by a Pakistani company to a foreign company, prior approval of the IPB is necessary unless the agreement falls within conditions and standards prescribed by the government. If these conditions have been complied with, approval is not required. In the past foreign investors have experienced difficulties obtaining government approval of royalty and technical fee agreements.

The GOP, however, is now in the process of reviewing and strengthening its intellectual property legislation.

Pakistan is a member of the World Intellectual Property Organization (WIPO), the Universal Copyright Convention, and the Berne Copyright Union. However, it is not a member of the Paris Convention for the Protection of Industrial Property. It accords U.S. citizens national treatment on patent, copyright, and trademark matters. Nevertheless, enforcement of copyright, trademark and patent laws is currently weak. Although a process may be patented, the final product cannot be patented in Pakistan. This has a direct impact on pharmaceutical and agrichemical compounds.

Discriminatory or Preferential Export Policies and Import Policies.

Exports. The GOP actively promotes the export of Pakistani goods by forgiving sales tax and import duty on both exported goods and raw materials imported for the production of those goods. The new export/import policy provides for full drawback of the Iqra or Islamic education tax, import surcharge, and import license fee. In addition, items of higher value added such as garments, engineering goods and electronics are eligible for a 75% income tax rebate while earnings on all other items are eligible for a 50% rebate. In the application of these policies, there appears to be no discrimination against foreign firms producing goods for export.

Imports. Despite steps to liberalize Pakistan's trade regime, tariffs cover a wide range of items and remain relatively high. The average nominal tariff is 67 percent, down from 77 percent in the early 1980s. The average tariff rate for consumer good imports (most of which are banned) is [illegible]5 percent. Capital and intermediate good imports face average rates of about 55 percent. There is also a 10 percent ad valorem surcharge and a 5 percent Iqra charge applied to all imports. Pakistan limits imports through two lists

BEST AVAILABLE DOCUMENT

identifying banned and restricted imports respectively. Goods not specifically banned can be imported. The "negative" list is made up of items banned for religious, security or luxury consumption reasons; capital and consumer goods banned to protect domestic industry; and intermediate goods used in producing protected goods. The "restricted" list includes items that may be imported only, for example, by certain parties (the Government or other specified users) or by certain means (such as credits or barter trade). Pakistan has established ceilings for the value of import licenses for machinery depending on the machinery's use.

Requirements for Joint Ventures. There is no legal requirement placed on the amount of equity a foreign investor may hold. However, the Government usually expects that the initial rupee expenditure for establishing the project would be met from local equity capital. In many cases, foreign investors have been allowed to hold majority equity, management, and control and the GOP has approved investments with 100 percent foreign equity.

(D) INVESTMENT INCENTIVES AND PERFORMANCE REQUIREMENTS:

The GOP has implemented a new investment policy which ensures that all incentives, concessions and facilities provided to domestic investors for industrial investment are also available to foreign investors without discrimination. A number of tax concessions, such as exemption from customs duty, sales tax concessions, a super tax rebate, and a tax exemption on investment, as well as guaranteed repatriation facilities have been introduced to accelerate industrial development in the country. While certain incentives are available to all foreign investors (see below), investors seeking additional incentives or concessions specific to their project must obtain BOI approval.

The following are standard incentives to foreign investors:

A four-year income tax holiday throughout Pakistan for key industries established up to the end of the Seventh Five Year Plan, i.e. June 30, 1993. Such "key industries" are bio-technology, fibre optics, solar energy equipment, computers and software, other electronic equipment and fertilizers.

To encourage industrial development in less developed areas, the GOP offers an income tax holiday of eight years for all industries located in the Northwest Frontier Province (NWFP), Balochistan, the Federally Administered Tribal Areas (FATA), the Northern Areas, Azad Kashmir, the Dera Ghazi Khan and Bahawalpur divisions of the Punjab and the Sukkur and Larkkana divisions of the Sind.

Customs duty exemptions on imported machinery are available to key industries provided that such machinery is not manufactured locally and that the industry was set up between July 1, 1988 and June 30, 1993. All industries proposed for the less developed areas listed in the previous paragraph are exempt from the import surcharge on imported machinery, in addition to customs duty and sales tax.

If the enterprise is to be located in one of the major cities, however, a 50 percent exemption of duty is available. Potential investors should keep in mind that duties can easily exceed 100 percent of value, so that even a 50 percent exemption can still leave the investor paying significant duties.

Sales tax concessions are granted to all goods exported from Pakistan. Sales tax exemptions are also available for the machinery and raw materials which go into the production of goods for export. Moreover, the output of industries established between July 1, 1988 and June 30, 1993 in the NWFP, Balochistan, FATA, the Northern Areas and Azad Kashmir are exempt from all sales tax for a period of 8 years.

Additional customs duty, sales tax exemptions and other incentives are available to specific industries, such as electronics, pharmaceuticals, and mining.

There are a number of incentives available to foreign investors, but the rules governing them are complex and administered by a bureaucracy given to micromanagement. The concessions available to any specific project are determined through negotiation. All investors are advised to make specific proposals regarding incentives and concessions directly to the BOI.

This combination of regulations and concessions result in a pattern of investment which would not occur if market forces played a larger role in investment decisions. GOP policies are designed to channel investment into those areas which are considered desirable for the economy, and which are seen to conserve foreign exchange.

Currently, GOP policies strongly favor investment proposals that have large export and local content components but amounts are negotiable. The local content policy, known as the "deletion policy," requires that all investments which are based upon local assembly of imported parts have a "deletion program" to raise local content. The Ministry of Industries monitors the deletion schedule closely and must approve any deviation. In addition, high duties discourage the import of finished products.

Some projects that have been sanctioned and are operating in Pakistan have had considerable difficulty meeting this requirement. The GOP deletion program timetable has often proven too tight for investors to organize a system of dependable, quality conscious local suppliers.

(E) ANTICIPATED CHANGES IN INVESTMENT POLICIES:

The GOP continues to move toward a "one-window" facility for investment proposals. The changes that have occurred combined with a broad consensus among top GOP officials that liberal investment policies are critical for continued economic growth should lead to an improved investment climate in the future.

(F) INVESTMENT DISPUTES:

Foreign direct investments are protected against expropriation by the Foreign Private Investment (Promotion and Protection) Act of 1976 and by an Investment and Guarantee Agreement (see below). A number of nationalizations took place between 1972 and 1975, but this primarily affected domestic Pakistani companies. Embassy files show only three cases involving potential property claims by U.S. citizens.

In 1972, the GOP nationalized most Christian schools, and this affected the United Presbyterian Church's Forman College. In 1986, the Prime Minister announced that former church-owned educational institutions would be returned to their previous owners, but it is unclear how this will affect Forman. The Church contended that the Nationalization Law was not meant to apply to the land and buildings of the college, and it is pursuing its claim for the return of these in the courts.

In 1976, the GOP nationalized wheat-flour mills, promising compensation to former owners and exempting foreign-owned operations. A mill with 41 percent U.S. ownership was affected by the nationalization. It is not clear whether the U.S. investor filed a formal compensation claim with the GOP and the status of this case is unknown.

In 1983, The Punjab Government took possession of land belonging to a U.S. citizen in order to build a monument. At first the compensation claim was challenged because the title to the land was disputed. In 1986, the Board of Revenue confirmed the U.S. citizen's title, and the Chief Minister of the Punjab directed that adequate compensation be made for earlier expropriation of urban property. The U.S. citizen is pressing his claim and hopes to receive an alternate piece of property in the same area as the original piece.

(G) BILATERAL INVESTMENT AGREEMENTS:

As of June 30, 1984, Pakistan had signed bilateral taxation treaties with 27 countries. That list includes the United States, the United Kingdom, West Germany, France, Japan, Austria, Denmark, Ireland, Poland, Sweden, Swiss Confederation, Sri Lanka, Malta, Canada, Thailand, Romania, Philippines, Netherlands, Malaysia, and Belgium.

Pakistan has four agreements in effe.. that affect investment. These are with West Germany, Canada, Libya, and the United States. The understanding with the United States is not an investment treaty but a Treaty of Friendship and Commerce and an Investment and a Guarantee Agreement. The Treaty of Friendship and Commerce provides a comprehensive, legal framework within which firms and individuals of either Pakistan or the United States can make investments, carry on business within the territories of the other, and settle disputes. The Treaty also contains provisions assuring basic personal freedoms and protection of persons and property and grants most-favored-nation status to nationals, corporations and trade goods of each country. The Investment and Guarantee Agreement provides the basis for the operations of the Overseas Private Investment Corporation (OPIC) in Pakistan.

The United States is now exploring with the GOP the possibility of negotiating a Bilateral Investment Treaty, but discussions are still in the preliminary stage. Negotiations of a a new Bilateral Tax Treaty may begin in late 1990.

(H) OPIC PROGRAMS:

OPIC has two principal functions in Pakistan. The first is to provide insurance against the risks of expropriation, currency inconvertibility, political instability; the second is to promote investment activities through investment missions and OPIC's Opportunity Bank. OPIC's main focus in Pakistan has been provision of insurance to U.S. companies for equity and other types of investments. In an effort to find a suitable U.S. counterpart, several Pakistani firms have expressed interest in the Opportunity Bank, but the program has not been widely used here. From time to time, OPIC has sponsored investment missions to Pakistan, the last in 1985. Britain has an investment insurance program in Pakistan similar to OPIC's.

(I) LABOR:

Labor Force. Unskilled labor is abundant and cheap in Pakistan. Unemployment and underemployment are fairly high, though official statistics are unreliable. Skilled labor in many fields, however, is in short supply. Among the factors responsible for this are the extremely high illiteracy rate (probably well over the official estimate of 75%). Other contributing factors include the attraction of many skilled workers to the higher salaries offered outside Pakistan (notably in the Gulf). This trend has reversed somewhat in recent years, and especially in the petroleum industry, U.S. companies have reported the availability of highly skilled employees. The Bhutto Government has begun to address the seriously deficient education system. Individual companies have reported good results from training programs initiated for their own workers.

Labor Costs. In larger towns, unskilled workers earn approximately $3.50 per day; semi-skilled workers, $6; and skilled workers, $12. Overall labor costs are actually much higher. Expenses include cost-of-living allowances or bonus payments plus housing, medical, retirement, and other benefits. Liberal leave benefits and high absenteeism also affect labor productivity. Representatives of the textile industry estimate that an unskilled worker's legislated minimum wage of $26 per month can actually cost employers three times as much. Foreign enterprises are often expected to pay higher wages and provide superior benefits to their employees.

Pakistani--both public and private--employers now are frequently resorting to contract labor as a means of escaping responsibility for many of the fringe benefits paid to regular employees, as well as to avoid the restrictions on laying off workers. Legal provisions for worker protection and benefits are widely violated and weakly enforced. Foreign employers, however, are more likely to be held accountable.

Labor-Management Relations. Relations between labor and management in Pakistan are generally peaceful, but not always cordial. U.S. companies with more modern approaches to labor-management issues have generally enjoyed good relations.

Organized unions exist in abundance but are generally small, fractious and organized within a single plant. Unions are barred from large sectors of employment (though not generally from industry) and legal limitations on strikes are so strict as to make them rare. The general poverty of the unions and lack of financial reserves by most workers are also deterrents to strikes. Lesser forms of labor agitation do occur, however.

Establishments employing 50 or more workers are required to have a Works Council. The Works Council is composed of management and worker representatives, whose mission is the preservation of good relations and the peaceful settlement of differences.

Many sore points exist between labor spokesmen and employers. Grievances arise chiefly over inadequate wages and benefits, failure to abide by legally required compensation and protection standards (and government failure to enforce them), and the growing practice of contract hiring, which unions claim makes employer accountability almost impossible (and also effectively freezes unions out of the picture).

Although the perceived grounds for labor unrest are widely present, most unions remain generally reluctant to undertake more than token agitation. As a group, organized labor is weak, divided and receives little effective support from government.

(J) FOREIGN-TRADE ZONE:

Pakistan's free trade zone is the Karachi Export Processing Zone (KEPZ), located in Pakistan's principal port. The KEPZ was established in 1980 to attract export-oriented industries, and investments can be made there in foreign exchange by foreign investors and Pakistanis working abroad. Exports from the KEPZ are free from exchange control. Imports of machinery, spare parts, and raw materials for the industries in the KEPZ are free from Federal, Provincial, and Municipal taxes and duties. Restrictions in the Import Trade Control Act are not applicable to imports for the KEPZ. Tax benefits to foreign investors were improved in early 1988. These along with other incentives are described below:

(a) a tax holiday until the year 2000 and a 25 percent tax break in perpetuity;

(b) the recent approval of the right to export from the KEPZ to Pakistan;

(c) an increase in the possible local investor shares in KEPZ industries from 15 to 40 percent;

(d) the equalization of foreign investors and overseas non-resident Pakistanis;

(e) capital gains on sale of assets and shares are exempt from tax.

(f) a "one window" facility promising the installation of utilities within two weeks of project approval;

(g) investors are exempt from most Pakistani labor laws but must adhere to KEPZ standards;

In addition to the KEPZ, industrial estates exist around the country near the large population centers such as Lahore, Peshawar, Rawalpindi/Islamabad, Faisalabad, and Multan. They offer inducements similar to those in the KEPZ, but some of the estates have been slower to provide adequate infrastructure support.

(K) Capital Outflow Policy. Current GOP policy prohibits Pakistani nationals from remitting foreign exchange abroad for direct investment. With special permission, however, Pakistanis are allowed to make foreign exchange investments abroad from export proceeds as well as to open branch offices for export promotion.

(L) Investment Data. The are no reliable data on the magnitude of foreign direct investment in Pakistan. The rate of private investment has likely increased since January, 1989, when the Bhutto administration began liberalizing private sector participation in the economy. Board of Investment approvals give some indication of this. the BOI sanctioned investments worth Rs 59.7 billion (about $2.7 billion) between July 1989 and March 1990. By contrast, investment was Rs 22.8 billion for the same period a year earlier and Rs 38.4 billion for the entire fiscal year 1989.

M) Major Foreign Investments. A comprehensive list of major foreign investments in Pakistan is not available. Foreign investment proposals approved by the Board of Investment during the past two years have been concentrated in several key areas - oil and gas exploration and discovery, hybrid seed development, orange juice concentrate production, private power plant projects, automobile manufacture, polyester fiber, fertilizer, and pharmaceuticals.

ANNEX-6

DESCRIPTION OF INFORMAL SYSTEMS OF CREDIT FOR MEs

A. The Committee System

The so-called committe system is an important source of capital for small businessmen in Pakistan. In this system businessmen (usually of the same trade) form a group and decide the terms and conditions of the committee. The members unanimously select the accountant of the committee. There are three types of committees which are being practiced among the business community:

1. Ordinary Committee.
2. Committee which is auctioned every month.
3. Lucky Committee.

1. Ordinary Committee

This is the simplest form of the committee and involves compulsory saving. The selected accountant usually collects a daily fixed amount from the members; sometimes this collection is made monthly. The procedure of this system is very simple. The first committee is given to the person who organizes the committee. From the second month onward the accountant of the committee writes down the names of the all committee members except the organizer (who has received the first committee) on different cards. These cards are shuffled and someone who is not a member of the committee (usually a child) is asked to draw a card. The committee is given to the member whose name is drawn. This procedure is repeated every time a draw is required. Those members who have drawn a committee once are not included in subsequent draws. The duration of the committee depends on the number of members.

2. Committee Which is Auctioned Every Month

This type of committee is very popular among the business community, especially in the big cities of Pakistan. The group is organized in the same way as in the ordinary committee and the first committee is given to the organizer. After this, the committee is auctioned every month on a fixed date. At the time of auction every member is supposed to be present; if a member is not present other members will not wait for him and the auction will start at the fixed time. The members will bid for the committee according to their need for funds. The committee will be given to the member who is willing to pay the highest premium to the contributors.

For example: Suppose there are 50 members, each of whom contributes Rs 1,000, so that the amount of the committee is Rs

SOURCE: Husain, Tariq, "Pakistan Credit and Support Services for Micro Enterprises", World Bank, April 1989.

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50,000. One member says that he is ready to take this committee for Rs 45,000. Another member whose need for money is more pressing might make an offer of Rs 40,000, and so on. If Rs 40,000 is the lowest amount any member is ready to take, the committee is given to this person, and the remaining Rs 10,000 will be equally distributed among the contributing members. This amount will be considered the profit of the committee. In this way, each member will contribute Rs 800 for the month instead of the normal Rs 1,000. In this arrangement those members who are not willing to pay a premium will get the committee at the end.

3. Lucky Committee

This type of committee became very popular in the past and later on it was banned under the regime of President Zia-ul-Haq; still, some people are practicing this committee illegally. In this committee system the organizer tries his best to make as many members as possible and announces the committee amounting to one-half to two-thirds of the total monthly collection.

Suppose there are two hundred members of the committee and Rs 400 is collected from every member each month, for a total of Rs 80,000. The organizer announces that Rs 50,000 will be given to the lucky member every month. The name of the winner will be drawn from the cards as in the ordinary committee; winners are excluded from subsequent draws, and they do not have to pay the remaining instalments. Those members who do not get the lucky committee but have paid Rs 50,000 into the committee are given back their contributions. In this arrangement some lucky members get a big amount while paying only a few instalments and the organizer gets a large profit every month.

B. Supplier's Credit

Supplier's credit is the most important source of credit upon which Pakistani MEs are relying. This informal source of credit has got such strong roots in the business community that even when they know the significant difference in raw material prices for payment in cash or credit, they still prefer this source because there is no other way out for them to meet their demand for credit for raw material. The implicit rate of interest has become part of the business practice of MEs.

Most of the MEs purchase raw material on credit and make the payment within two to six weeks. In this arrangement the borrowers often have to pay an implicit rate of interest of 10-15 percent per month, although interest rates of 2-3 percent per month are also observed. These estimates are derived from the difference in prices paid for cash purchases as opposed to purchases on credit.

In the metal products industry, the price of scrap metal

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bought as raw material in Lahore is Rs 7-8 per kilogram if purchased on cash payment, and Rs 7.75-8.75 per kilogram if purchased on credit. This additional price depends on the agreement between the buyer and seller about the time of payment. If the buyer wants more time to pay, the seller charges a higher price. The time of payment ranges from 15-30 days. This type of arrangement is practised for nearly all types of raw material for the metal industry.

One of the MEs involved in the leather products sector surveyed in Rawalpindi reported that they had purchased raw material on credit worth Rs 11,500. According to the respondent, he would have purchased the same quantity and quality of raw material for Rs 10,000 if he had been able to pay in cash. Another ME of the same sector in the same city reported that they purchase raw material on credit at the rate of Rs 60 per kilogram on credit, while the same material can be purchased at the rate of Rs 55 per kilogram on cash payment.

In the textile industry in Faisalabad, the price of raw material was Rs 30 per pound. The suppliers charged a higher price according to the length of time before payment. They charged Rs 0.50-0.75 more per pound if the buyer made a promise to pay the loan amount within 20-30 days. The suppliers charged an extra Rs 0.75-1.5 if the buyer made an agreement to pay his dues within 30-45 days, and an extra Rs 2 per pound for payment made after 60 days.

The price of raw material incorporates not only an interest rate, but also a quantity discount. In the metal products industry, somebody purchasing raw material in kilograms would pay a higher price compared with a buyer who purchased raw material in tons. An intersting thing found during the field work was that "cash payment" meant payment within a week of purchase of raw material.

C. Buyer's Advance

Buyer's advance is also a source of credit for working capital for some of the smallest MEs. In this arrangement buyers make some of the payment in advance and the enterprises use this advance to purchase raw material. This type of credit is generally free of interest and the amount of credit is deducted from the price of the final good at the time of payment. This source of capital is very important for shoe makers and wood furniture makers who are working at a very small scale in Rawalpindi.

In some cases observed in Lahore, intermediaries (buyers) provide capital to MEs for working capital. They make sub-contracts with MEs, i.e., they buy the products of MEs, deduct the amount of credit advanced from the total value, and make the remaining payment. In this arrangement the buyers charge an implicit interest from MEs which varies from 6-8 percent per fifteen days by paying, say, Rs 15 per kilogram for products which the MEs can sell for Rs 16-16.5 per kilogram if they were not borrowing from the buyer. Thus, the rate of interest charged by the buyer who provides an advance to the producer is reflected in the form of a discounted price in this arrangement.

D. *Parchi* (IOU)

The *parchi* system was found during the field work in the textile and leather sector in Faisalabad. The *parchi* is a piece of paper issued by the intermediaries on receiving a bulk of output from MEs. The quantity of output received, the price per unit, the total payable amount, and the date on which payment is due are mentioned on this paper. The usual *parchies* observed in the market have three maturity periods: 20-30 days; 30-45 days; and 45-60 days.

When the MEs take their product to the market they ask the intermediaries before-hand about the mode of payment. If the payment is to be made in cash, MEs sell their produt relatively cheap. If the intermediaries ask them to take a *parchi*, an IOU, MEs charge a higher price from them according to the maturity period of the *parchi*. The *parchi* is acceptable in the market just like a check. If the bearer of the *parchi* wants to get it cashed he will have to pay a certain rate of discount which varies according to the maturity period of the *parchi*. The *parchi* is also used by microenterprises to make payments to suppliers.

The interest rates implied by the various arrangements involving the *parchi* are given below.

Parchi Type	Maturity (days)	Implicit Interest Rate When ME is Selling Its Goods (%/month)	Implicit Rate When *Parchi* is Used to Pay Suppliers (%/month)	Discount Rate for Cashing The *Parchi* (%/month)
1.	20-30	2.0-2.5	1.7-2.3	2.5-5.0
2.	30-45	3.1-6.2	2.3-5.0	3.8-7.5
3.	45-60	4.4-7.0	6.0-7.0	5.0-10.0

There is a big risk in this arrangement for the whole sector. If the business of the borrower collapses, all the bearers of the *parchies* which he had issued would lose their money and they would have no legal way to get their money back from him.

E. Money Lenders

Money lenders are the only source among informal sources of credit who provide credit to relatively big businessmen. This source of credit is not very popular among MEs. The major borrowers from money lenders are transporters, textile mill owners, property dealers and stockists. In some cases people get loans from money lenders for their household needs. Money lenders give loans to those people whom they trust, or those who provide a guarantor. The rate of interest varies from 2-4 percent; the amount of interest is paid to the money lender every month. The maturity period of the loan is decided at the time of agreement; however, the lender can take his money back from the borrower with prior notice.

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