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Reform of Regulatory Framework: Cotton Ginning Sector

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Abstract

Pakistan is one of the world's largest producers and consumers of cotton. Pakistan cotton's key characteristics are good; however, it does not yield high prices due to unacceptable contamination levels. The extent of losses due to contamination and lack of grading is estimated to run into USD 1.4 billion to 3 billion. Low cotton prices appear to be an important contributor to poverty in Pakistan's cotton producing regions, which are one of the poorest in Pakistan and any effort to improve prices will have a direct impact on poverty reduction in these areas.

High contamination levels and other issues with Pakistani cotton are a direct result of a weight-based pricing system, which suits a substantial number of Pakistani weaving and spinning units. These units are in the business of production of coarse cotton cloth and do not have or generate demand for clean cotton. This lack of demand coupled with inadequate regulation has led to a near complete collapse of product differentiation systems. This report focuses on the regulatory aspects of this failure.

Regulations in the cotton sector cover nearly every part of the value chain. These regulations take the shape of twelve laws, seven of which are exclusive to the cotton sector; however, these regulations/statutes have not been able to facilitate production and processing of high value cotton. There are a number of reasons for this failure. First many of these laws are outdated and do not take note of improvements in cotton grading/standardization and marketing. For instance the major law in the area – the Cotton Control Ordinance still focuses on maintaining varietal purity when this characteristic does not drive buying decisions any more. Regulation in fact does not provide for comprehensive labeling and/or disclosures key to buying decisions. Second regulation has been unable to address the market causes of contamination. Third regulation is intrusive and attempts to control factors, which are related to operation of markets. Fourth regulation enforcement is weak because of lack of resources, inappropriate focus, multiplicity and overlaps.

This document recommends that the regulatory regime in the cotton sector be redone to support labeling and encourage ginning factories to bring technological improvements. The document suggests that this should be done by reducing the number of statutes, removing inconsistencies and overlaps, clearly delineating regulation responsibilities, encouraging voluntary certification and restricting intrusive regulation. The document further suggests that the regulatory regime should move away from ensuring varietal purity and focus on adequate labeling. Again it calls for providing incentive to spinners in the shape of lesser or no payment of cotton cess, to buy labeled bales. It also suggests that research in cotton should be funded through budgetary appropriations and cotton cess should be used for technology improvements.

Acronyms

FBR	Federal Board of Revenue
FY	Financial year
PCSI	Pakistan Cotton Standards Institute
SRO	Statutory Regulatory Order
UNDP	United Nations Development Program
US	United States
USAID	United States Agency for International Development

Definition of key terms

Cotton grading:	Determination of quality in terms of color and trash.
Cotton classification:	Determination of quality on the basis of grade and staple length.
Cotton evaluation:	Determination of quality in terms of grade, staple length, and other fiber properties.
Ginning:	The process of separating lint (raw cotton fiber), cottonseed and trash.
Micronaire:	An instrument used for measuring the fitness or maturity of a cotton sample.

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Executive Summary

Pakistan is the world's fourth largest producer and third largest consumer of cotton. The country produced 9.6 million bales of cotton in 2009-10 while it consumed 10.9 million bales in the same year. However Pakistan's share in the international cotton trade is not significant - it imported 1.5 million bales and exported 0.2 million bales of cotton in 2009-10 .Pakistan cotton is generally of medium staple length (2.38 cm to 3.15 cm), its fiber strength is high and its micronaire values are acceptable. Pakistan cotton is stress-free and handpicked although picking practices are not of an international standard.

Pakistan cotton does not attract high values and yields significantly lower prices than cotton of similar grades due to high levels of contamination, inappropriate moisture content and mixing of different grades of cotton. All of these issues are considered to be a direct outcome of the prevailing weight based pricing system and/or absence of viable product differentiation systems.

Impurities reduce the beneficial effect of cultivars and impair the rating of yarn and fabric preventing the manufacture of a final product with high value. The level of contamination in Pakistan cotton can be gauged from a survey carried out by the International Textile Machinery Manufacturers Federation, which found Pakistan cotton as being one of the most contaminated in the world. In fact the International Textile Manufacturing forum advises member textile units to avoid using yarn and fabrics originating from Pakistan due to contamination. Various estimates place the contamination content of Pakistan cotton at 18-19 grams per bale against an international standard of 2.5 grams. Various estimates place the value of loss suffered by Pakistan due to contamination at USD 1.4 billion to 3 billion in export earnings each year. Of this loss USD 308 million is estimated to occur at the stage of raw cotton alone.

Contamination occurs throughout the value chain. The major reasons for contamination appear to be lack of awareness regarding benefits of clean cotton, low economic incentive for picking, and keeping cotton clean and/or demand for clean cotton. Low economic incentive occurs due to unwillingness at various levels of the value chain to transfer monetary benefit of clean cotton to the lower rung. Lack of demand for cleaner cotton is due to the reason that majority of Pakistan cotton cloth producers are engaged in production of coarse cotton cloth (known as the power loom sector), which does not require high quality cotton and accordingly these manufacturers do not appreciate or pay premium for clean cotton.

The lack of economic incentive/demand for clean cotton has led to absence of product differentiation, which manifests itself in cotton bales being either not labeled or incorrectly labeled. Further labels do not indicate specifications/contents of the cotton bale despite the presence of a national grading system. In terms of technological advancement, lack of incentive/demand for clean cotton has translated into poor factory infrastructure, low quality machines, poor picking, transport, storage and ginning practices. As a result, most ginning factories in Pakistan operate with poor quality machines; ginner mix cotton of different grades , pickers start picking cotton early in the morning , and farmers store cotton in polypropylene bags; all intended to obtain maximum production by weight at the lowest cost. The impact of the weight-based system is so

intense that lint-cleaning machines present in factories have been removed due to their weight-reducing cleaning action.

The above noted situation in the Pakistani cotton market has not been helped by the cotton regulatory regime, which fails to provide for or encourage product differentiation and/or appropriate labeling despite the fact that it regulates nearly every segment of the value chain. It is also marked by poor enforcement systems, repetitive and confusing compliances and overlaps. Current regulation in the cotton sector and how regulation can help the market to move towards a quality based pricing system- a declared government objective - is the subject of this report.

1.0 Introduction

The Pakistan cotton sector is regulated by a number of federal and provincial statutes. The details of these statutes and the span of their control are as follows:

1.1 Regulation of the Cotton Sector



Provincial Cotton Control Ordinance, 1966	Provincial Cotton Control Ordinance, 1966	Provincial Cotton Control Ordinance, 1966		
Cotton Transport Act, 1923	Cotton Transport Act, 1923	Cotton Transport Act, 1923		
	Agricultural Produce Markets Ordinance, 1978		Agricultural Produce Markets Ordinance, 1978	
		Cotton Ginning and Pressing Factories Act, 1925		
		Cotton Standardization Ordinance, 2002	Cotton Standardization Ordinance, 2002	
				Cotton Industry (Statistics) Act, 1926

			Cotton Cess Act, 1926	Cotton Cess Act, 1926
			Cotton Act, 1957	
		Sales Tax Act, 1990	Sales Tax Act, 1990	
Pakistan Plant Quarantine Act, 1976	Pakistan Plant Quarantine Act, 1976			
Seed Act, 1976				
		Cotton Ginning (Control and Development) Act, 1976		
			Imports and exports (Control) Act, 1950	

2.0 Federal and Provincial Statutes

2.1 Provincial Cotton Control Ordinance, 1966

The Cotton Control Ordinance is a provincial law originally promulgated as the West Pakistan Cotton Control Ordinance 1966 and the only comprehensive regulation with regard to cotton ginning. The statute is supplemented by the Punjab Cotton Control Rules of the same year. The Ordinance has multiple objectives, which include establishment of the Cotton Control Board, tax collection, control of contamination in cotton and product differentiation. These objectives are achieved by introducing a regime of registrations, paper work compliances, bale markings, cotton factory plan approvals and physical inspections. Enforcement is undertaken by Cotton Inspectors appointed by the Provincial Government. The law requires the following compliances:

- a) **Registrations:** Section 7 of the Ordinance requires every ginning factory to obtain a license from the provincial government. Licensing and license renewal is used for purposes such as structural, technological/information compliances and tax collection (provincial ginning tax).
- b) **Sowing prohibitions:** Section 16 and 21 empower the Government to prohibit sowing of particular varieties of cotton in specified areas. This is a key provision of the Ordinance, on which a number of other provisions (especially import prohibitions and contamination requirements) of the Ordinance are based.
- c) **Import prohibitions:** Section 22 of the Ordinance empowers the provincial government to prohibit import of specified varieties of cotton in areas where their cultivation is prohibited. Section 23 and 24 lays down the mechanism for implementing these import prohibitions.
- d) **Marking compliances:** Section 13 requires bales to be marked to enable determination of their factory origin and the year of cotton produce they contain.
- e) **Contamination requirements:** Section 17 of the Ordinance prohibits handling of cotton in non-cotton bags, watering of seed cotton or lint cotton beyond 8.5%, allows entry of any foreign substance in cotton and/or ginning/pressing of such cotton. Section 16 prohibits the admixture of cotton of different varieties.
- f) **Structural/technological compliances:** Section 7 and 15 of the Ordinance lay down structural and technological requirements for ginning factories. These requirements include construction of such numbers of raised and paved platforms (for keeping varieties separate) as the Government may require, installation of pre-cleaning and lint cleaning machinery and replacement of each and every saw of ginning machines after ginning of 3000 bales.

- g) Standardization compliances: Section 7 requires a ginning factory to have PCSI Standard grade boxes for seed cotton and lint. Section 27 empowers the Government to regulate the grading, standardization and marketing of cotton by notification. Section 14 requires use of weights and measure prescribed by the Weights and Measures (International system) Enforcement Act, 1975.
- h) Trade and commerce related compliances: Section 26 empowers the Government to the price of cotton and cottonseed. Section 25 empowers the Government to prohibit ginning of cotton, which has been reserved for procuring pure seed for purposes of sowing by the prescribed authority
- i) Paperwork compliances: Section 8 of the Ordinance requires the occupier of a cotton factory to maintain separate registers regarding i) Cotton received daily, ii) Record of cotton ginned each day, and iii) Record of bales pressed daily
- j) Information rendering: Section 10-12 of the Cotton Control Ordinance lays down the returns that ginning, pressing and cotton seed oil factories need to file with regard to their production. These provisions of the Ordinance also require the prescribed authority to compile and publish this information.

The Ordinance provides a more comprehensive regime with regard to import prohibitions and standardization, marketing and grading of cotton as compared to the Cotton Transport Act and the Cotton Ginning and Pressing Factories Act. The Ordinance is enforced through court imposed fines and/or factory closures.

The Ordinance is based on the concept of maintaining varietal purity for ginning purposes and thereby ensuring cotton quality. The Cotton Control Ordinance is administered by the provincial Departments of Agriculture, which is inappropriate as many of its provisions relate to industrial processes, which should ideally be allotted to the provincial Department of Industries. Again some of the issues dealt with by the Cotton Control Ordinance like sowing prohibitions belong to agricultural law and should be dealt with separately.

An analysis of the Ordinance reveals a number of issues. First, there are a number of inappropriate requirements. For instance, it requires the same kind of infrastructure and machinery for ginning factories, pressing factories and cottonseed oil factories when these have separate machinery and structural requirements. Second, the Cotton Control Ordinance tries to achieve product differentiation by requiring cotton bales to carry 'marks of origin' which information is insufficient/ no more crucial to the buyer. Third, the provisions regarding standardization are elementary. Fourth, a number of compliances in the Ordinance are simply unenforceable, for example, it is impossible to police cotton pickers in cotton fields because their numbers run into millions.

2.2 The Cotton Ginning and Pressing Factories Act, 1925

This is a Federal Act administered by the Provincial Governments except in Sind province where it has been repealed. The law requires the following compliances:

- a) Paperwork compliances: Section 3 of the Act requires the occupier of a cotton factory to maintain separate registers regarding i) Record of cotton ginned each day , and ii)Record of bales pressed daily
- b) Marking compliances: Section 4 of the Act requires pressing factories to mark bales to help determine their origin.
- c) Structural/Technology Compliances: Section 9 of the Ordinance requires ginning factories to have separate entry and exit requirements with regard to un-ginned and ginned cotton and to have paved flooring. It also requires new factories to obtain approval of spans and specifications except in case of factories with four or less roller gins.
- d) Standardization compliances - Section 6 requires factories to use scales and weights prescribed by the Federal Government.
- e) Information rendering- Section 5 of the Act requires weekly returns of pressed cotton bales to be furnished to the provincial government. Section 5A requires similar weekly returns to be filed with regard to ginned cotton. The Provincial governments are under an obligation to compile and publish this information.

The Ginning and Pressing Factories Act was the first enactment to regulate the working of cotton ginning factories. The Act is enforceable through fines imposed by courts and suspension of work in factories. Rule making powers are vested in the Federal Government in respect of marking of bales and the Provincial Government in respect of maintenance of paperwork/records, submission of information and structural requirements. The Act is practically superseded in nearly all respects by the West Pakistan Cotton Control Ordinance, 1966 and the law is now no more implemented in any province.

2.3 The Cotton Transport Act, 1923

The Cotton Transport Act, 1923 is a federal law the main thrust of which is, control of transport and import of, cotton by rail in controlled areas. While the Act allows provincial government to prohibit import of specified cotton through any means it does not provide mechanisms within the statute to control import through means other than railways and leaves these matters to rule making. Compliances required by the Act are as follows:

- a) Import compliances-Section 3 of the Act allows the provincial government to prohibit the import of specified cotton in any area by rail, road, river and sea in order to maintain the quality or reputation of cotton grown in the area.

- b) Transport compliances - Section 4 allows (and obliges) the Station Master of any railway station to refuse to receive or transport cotton of a prohibited kind into a notified area.

The Act is enforceable through fines and/or imprisonments imposed by courts. Rule making powers under the Act are vested in the provincial governments. The provisions of the Cotton Transport Act regarding prohibition of import of specified cotton in a notified area and the power of a station master to refuse to carry prohibited cotton into a notified area stand superseded by Section 22 and 23 of the Cotton Control Ordinance, 1966 respectively. Nevertheless, the Act has however not been repealed by the Cotton Control Ordinance.

2.4 The Cotton Industry (Statistics) Act, 1926

This is a Federal Act administered by the four Provincial Governments. Compliances required by the Act are as follows:

- a) Paper-work compliances - Section 3 requires cotton mills (Mills engaged in the production of cotton goods and cotton yarn) to keep a record of goods produced and yarn spun.
- b) Information rendering compliances - Section 3 requires cotton mills to render information about goods produced and cotton yarn spun. The Provincial governments are under an obligation to compile and publish information regarding cotton goods produced and cotton yarn spun.

Rule making powers under the Act are vested in the provincial government. Enforcement of the Act is through fines imposed by courts.

2.5 The Imports and Export (Control) Act, 1950

Export of cotton from Pakistan is regulated by the Export policy and procedures Order, 2000 which is an Order issued under section 3 of the Imports and Exports (Control) Act, 1950. The Order provides various types of entities that can undertake export and the manner and procedures of exports. Section 6 of the Order empowers the Federal Government to allow exports in relaxation of the provisions of the Order.

The Order allows export of cotton subject to fulfillment of the following requirements:

- a) Export Contract Registration - Registration with the Export Promotion Bureau (now the Trade Development Authority of Pakistan), against a security deposit of 2% of the contract value along with cotton grading and classification certificate issued by the Pakistan Cotton Standards Institute
- b) Letter of Credit - An irrevocable Letter of Credit to be opened within 35 days and the shipment of the contracted quantity shipment to be completed within 180 days of the registration of the contract.

The Order overlaps with the Cotton Act, 1957 in the matter of registration of cotton export contracts when a similar requirement exists under section 9 of the Cotton Act.

2.6 Cotton Standardization Ordinance, 2002

The Cotton Standardization Ordinance, 2002 is a federal statute administered by the Pakistan Cotton Standards Institute. The Ordinance is supplemented by the Cotton Standardization Rules of the same year. The Ordinance puts into effect the recommendations and work of a UNDP project from 1983 to 1986 to promote standardization of cotton in Pakistan. The Ordinance does the following things:

- a) PCSI - Establishes the Pakistan Cotton Standards Institute (PCSI) with the mandate to establish cotton standards and recommend measure to provincial governments for producing contamination free cotton, conduct training and examination in cotton grading and cotton classing and awarding certificates
- b) Empowers PCSI - To place classers in ginning factories and to report to Cotton Inspectors if standardization procedures and technical requirements are not complied by a ginning factory
- c) Standardization Fee - Empowers the PCSI to charge a standardization fee as charges of standardization of cotton at a rate fixed by the Federal Government

The Ordinance is a constituting law – it constitutes a non- departmental public body - and prescribes its powers and duties in detail. The Statute approaches the issue of implementation of cotton standards by assigning the task to private classers. This approach has been unsuccessful with many ginning factories not accepting classers and/or disallowing them from entering ginning factories. The work done by the Institute till date is formulation of gradation standards for Pakistan Cotton, issuance of gradation certificates to cotton exporters and training of 180 classers and 19 female fiber-testing technicians. Subsequent to declaration of Pakistan Cotton standards by PCSI, Pakistan cotton has been quoted on Cotlook Price Index A while previously it was quoted on Cotlook Price Index B which has given Pakistan Cotton a price differential of five to seven US Cents per pound.

2.7 The Cotton Act, 1957

The Cotton Act, 1957 is a federal statute with the declared objective of promotion of international trade. The Act performs the following actions:

- a) Pakistan Cotton Board - Establishes the Pakistan Cotton Board with the mandate to supervise and regulate all dealings in cotton in so far as they are connected with the promotion of international trade
- b) Requisition pressing factories - Empowers the Federal Government to requisition pressing factories and use the same for pressing and storing cotton belonging to the Federal Government.
- c) Empowers the Federal Government - To purchase cotton and appropriate it towards fulfillment of a defaulting international contract with the defaulter bearing the loss if any.

- d) Registration -Requires registration of contracts for export of cotton.
- e) Regulation - Empowers the Federal Government to regulate forward contracts or hedge contracts in cotton.

The Cotton Act is an inappropriately named statute as it does not deal with the whole cotton value chain and/or regulate the production or ginning of cotton. The provisions of registration of cotton contracts overlap with the Export policy and procedures Order, 2000.

2.8 The Seed Act, 1976

The Seed Act, 1976 is a federal statute, which establishes the National Seed Council, the Federal seed certification agency, the National registration agency, Provincial seed councils and regulates the production and use of seeds. Regulation is conducted by determining suitability for registration as a variety, registering seed varieties and ensuring that seed of notified varieties is not sold unless it complies with disclosure and standardization requirements.

The Seed Act empowers the Federal Government to specify the varieties or species of seed approved for production in any province or part thereof. The Act does not adequately deal with regulation of non-notified varieties and/or enforcement of geographical restrictions on sowing of varieties.

2.9 The Pakistan Plant Quarantine Act, 1976

The Plant Quarantine Act, 1976 is a federal statute, which gives effect to the International Plant Protection Convention, 1951. The Act is supplemented by the Plant Quarantine Rules, 1976. The Act and Rules require and empower persons responsible for carriage of goods by air, rail or sea, to refuse receipt, for carriage or carry plants subject to control by the Government or receive them for carriage or carry them subject to such conditions as the Government has imposed. The Act empowers the Federal Government to delegate its powers pertaining to the prohibition or restriction of bringing into or taking out of any place within a province or the sale of plants imported in contravention of any provisions of the Act to the provincial governments. The Act does not directly affect cotton ginning, but it is used to control the import of cotton plants in the country.

2.10 The Cotton Ginning (Control and Development) Act, 1976

This is a federal Act, which provided for the nationalization of ginning mills during the 1970s. The Act is now of historical significance only.

2.11 The Cotton Cess Act, 1923

The Cotton Cess Act, 1923 is a federal Act, which establishes the Pakistan Central Cotton Committee and imposes a cess on cotton consumed in or exported from Pakistan. The Pakistan Central Cotton Committee is a non-departmental public body attached with the Ministry of Food and Agriculture. The Act requires the following compliances:

- a) Payment of cess by spinning mills
- b) Expenditure of cess by the Pakistan Central cotton Committee on promoting agricultural and technological research in the interests of the cotton industry

The Pakistan Central Cotton Committee is a cotton research organization based in Karachi with a network of six cotton research stations and three cotton research institutes. The cess collected by the Central Cotton Committee has been used till date for development of 38 cotton varieties.

2.12 The Agriculture Produce Markets Ordinance, 1978

The Agricultural Produce Markets Ordinance 1978 is a provincial law which controls trade in selected agricultural commodities by requiring these commodities to be sold in notified markets (in the physical sense of the word). The term agricultural produce includes both ginned and unginned cotton (phutti). The Act establishes market committees to oversee the establishment and operation of these markets. Compliances required under the Ordinance are as follows:

- a) Licensing of dealers: No person can carry on work as a broker in the market unless he/she has obtained a license to work as such.
- b) Payment of Agriculture Market Committee fee: Any agricultural produce brought or sold by or through a dealer is liable to payment of the market committee fee.
- c) Prohibition on sale and purchase of notified agricultural produce outside markets: Section 4(3) of the Ordinance prohibits setting up of a market or undertaking sale and/or purchase of agricultural produce outside of a notified market premises. This prohibition does not apply to growers who sell their own produce.
- d) Prohibition on dealing in non-notified agricultural produce in markets: Section 4(4) of the Ordinance prohibits dealing in non-notified agricultural produce in notified markets.
- e) Establishment of warehouses and storage facilities: The Ordinance requires market committees to establish Markets, which provide storage, weighment and such other facilities as the Government may direct.

The Agricultural Produce Markets Ordinance was intended to provide for sale and purchase of agricultural produce in a place where necessary market facilities were present. However, most market committees did not provide these facilities leading to losses to growers from lack of processing and storage capacities and payment of lesser prices by dealers. The Ordinance is considered to be a key reason of poor prices in the agricultural sector.

2.13 Special Procedure for ginning Industry Rules, 1990

The Special Procedure for Ginning Industry Rules, 1990 are industry specific sales tax rules issued under section 71 of the Sales Tax Act, 1990. The Rules require the following compliances:

- a) Registration with the Sales Tax Department: Every ginning unit must be got registered with the Collector of Sales Tax.

b) Maintenance of record: A ginner must maintain record specified in the Sales Tax Act 1990 for purposes of payment of sales Tax. Delivery of ginned cotton is only acceptable through delivery note or gate passes: Rule 6 requires that ginned cotton shall only be delivered to a spinning unit or registered exporter through a delivery note or gate pass only.

The Ginning Industry Rules 1990 requires much more elaborate record keeping than either the Cotton Ginning and Pressing Factories Act or the Cotton Control Ordinance. However, there is likelihood of inaccurate record keeping/double book keeping under these Rules and reliance on the same may not give a true picture of cotton production in any province.

2.14 The Oilseeds Committee Act, 1946

This is a federal Act whose application on cotton is unclear. Cotton is an oilseed but it is already subject to the payment of cotton cess, which is used for research in cotton. The Oilseeds committee Act does a similar job with regard to all oilseeds.

3.0 Regulatory Shortcomings

3.1 Policy aspects

a) Classification/gradation of cotton/disclosures regarding cotton

The existing cotton regulatory regime is based on maintaining varietal purity. Information regarding variety is conveyed to the buyer by means of a mark, which indicates the origin of the bale and the crop year to which the cotton belongs.¹ This information coupled with prohibitions on sowing and ginning particular varieties of cotton in designated areas² and restrictions on moisture content³ is supposed to convey information about the contents of a cotton bale to the buyer. Information regarding weight is conveyed by legally fixing the weight of the cotton bale at 170 kilograms.⁴ In order to further ensure achievement of objectives regarding varietal purity, moisture, and trash content, the law requires technological compliances like having separate platforms, presence of lint cleaning machinery, availability of technical staff.⁵

Trading does not take place on the basis of varieties any more. This is so because varieties are not detectable through inspection and many varieties have similar characteristics. In fact, key characteristics of cotton, which have an impact on buying decisions in well functioning cotton markets and which should be disclosed to the buyer are staple length, color grade, trash content, moisture content, fiber fineness, and fiber strength. This information is not conveyed to the buyer in Pakistan, because there is no legal requirement or demand for the same,⁶ despite the fact that Government has declared its desire to base cotton classification on grading and staple length as compared to variety.⁷ Further even information regarding varietal content required by the existing regulatory regime is incorrect because there is no enforcement of varietal purity provisions and mixing of cotton varieties is rampant. Again while the Cotton Standardization Ordinance, 2002 provides for issuance of cotton standards it does not positively require disclosure of grades or other key information regarding cotton bales.⁸

b) Information/documentation of cotton/cotton seed production/cotton yarn

The existing regulation regime has substantial focus on maintenance of records and rendering of information regarding various aspects of cotton production and processing. Information is

¹ Section 13(1), 13(2), Cotton Control Ordinance, 1966

² Section 16,17,21,22,Cotton Control Ordinance, 1966

³ Section 17,Cotton Control Ordinance, 1966

⁴ Section 2(c), Cotton Control Ordinance, 1966

⁵ Section 7(1), Cotton Control Ordinance, 1966

⁶ While section 27 of the Cotton Control Ordinance, 1966 empowers the provincial government to regulate grading and standardization it has not happened and there is no sanction behind this power

⁷ (FAO and UNDP, 2001, p. 120)

⁸ See section 12-14, Pakistan Cotton Standardization Ordinance, 2002

collected for taxation, planning and regulatory purposes. Summary of information rendering/documentation requirements under various cotton regulation laws is as follows:

Table 1: Documentation Requirements

Type of return to be filed/Information to be rendered	Law requiring filing of return/rendering of information	Purpose
Returns showing the total number of bales of cotton pressed by pressing factories	Section 5(1), Cotton Ginning and Pressing Factories Act, 1925	Data gathering/gathering information about cotton markets
Returns showing the total number of cotton ginned by ginning factories	Section 5A(2), Cotton Ginning and Pressing Factories Act, 1925	Data gathering/gathering information about cotton markets
Returns of cotton ginned	Section 10, Punjab Cotton Control Ordinance, 1966	Data gathering/gathering information about cotton markets
Returns of cotton pressed	Section 11, Punjab Cotton Control Ordinance, 1966	Data gathering/gathering information about cotton markets
Return of cotton seed crushed	Section 12, Punjab Cotton Control Ordinance, 1966	Data gathering/gathering information about cotton markets
Return stating all cotton goods manufactured and all cotton yarn spun	Section 3, Cotton Industry(statistic) Act, 1926	Data gathering/gathering information about cotton goods/yarn markets
Return stating the total amount of cotton consumed or brought under process by spinning mills	Section 6, Cotton Cess Act, 1923	Assessment of Cotton Cess
Records to be kept as prescribed by the Sales Tax Act	Sales Tax Act, 1990 – Rule 9 Special procedure for ginning industry rules, 1996	Assessment of Sales Tax

While information collection is key to informed decision making, multiple information requirements lead to unnecessary compliance burdens and can be rationalized. Further data about cotton production can also be collected through geographical information systems and the Departments should focus on developing such systems rather than relying on cotton ginning factories for this information. The regulatory regime should also provide for sharing of information between government departments to reduce compliance requirements.

c) Regulation of trade in cotton/cotton prices

The current regulatory regime also regulates export of cotton so as to ensure compliance with international trading practices in cotton and/or maintaining credibility.⁹ Although these are acceptable objectives they should be achieved in both the local and international markets. Enhanced regulatory requirements for international trade especially where the volume of export is neither high in terms of volume or value does not create sufficient incentives for improving market conditions. Again while price fixation powers are present in law¹⁰ there is no evidence that they have been used to fix premiums or discounts. In the absence of such use of this power these are anti-market provisions and should be repealed.

d) Research in cotton

The Cotton Cess Act provides for collection of a cess to improve agricultural and technological research in the interests of the cotton industry. This cess is paid by spinning mills and is currently used for developing cotton varieties. Developing of cotton varieties is a public good and should ideally be funded from budgetary appropriations. This cess could be used for bringing technological improvements in ginning factories, which are likely to have a more direct impact on the cotton industry than development of cotton varieties.

e) Revenue collection

The two main indirect taxes, which are collected from the Ginning industry are sales tax and ginning tax. The former is a federal tax and is collected by the Federal Board of Revenue while the latter is a provincial tax and is collected by the Provincial Excise and Taxation Department/Agriculture Department. Both taxes are collected through a licensing regime, which enables tax authorities to keep a tab on the number of ginning factories and their output. A summary of these licensing requirements is as follows:

⁹ See section 7, Cotton Act, 1957

¹⁰ See section 26, Cotton Control Ordinance, 1966

Table 2: Licensing Requirements

Type of registration/licensing	Law requiring registration/licensing	Purpose
Registration with FBR	Sales Tax Act, 1990 – Rule 3 Special procedure for ginning industry rules, 1996	Collection of sales tax
License for establishing/working/altering cotton ginning and cotton pressing factories	Section 7, Punjab Cotton Control Ordinance, 1966 ¹¹	Payment of provincial tax on ginning/regulation of ginning and pressing factories

Revenue collection is suffering because of the inadequacy/inability of the current regulatory regime to ensure universal marking/identification of cotton bales, which is the best way to determine the exact quantum of cotton bale production and consequent collection of both sales tax and ginning tax.

f) Enforcement issues

Many stakeholders identify weak enforcement as the key reason in the failure of the existing regulatory regime. Enforcement failures however stem from a number of reasons. These reasons include the very nature of regulation, inadequacy of resources for enforcement and court management practices.

Enforcement failures stem from the nature of regulation when there is simply no way to enforce. For instance while it is easy to require that pickers will use cotton bags for storage of wheat, it is very difficult to enforce this provision simply because the number of cotton pickers extend to hundreds of thousands at any given point of time. Again enforcement of technological/structural requirements is poor because these compliances raise costs, which are not paid by the market and ginners pay rents to avoid compliance. A similar situation exists with transport prohibitions, which are violated because of the deeply entrenched weight based pricing system, which encourages admixture of different varieties of cotton.

Enforcement is also affected by inadequacy of funds and equipment for enforcement staff. Low salary of enforcement officers also encourages rent seeking. Detail of Institutions and actors charged with enforcement of various key regulations is as follows:

¹¹ Also see Rule 12, Punjab Cotton control rules, 1966

Table 3: Enforcement of Key Regulations

Broad area	Nature of action/compliance	Enforcement by
Classification/gradation of cotton		
Maintaining desirable level of capacity and infrastructure in ginning factories	Registration of cotton ginning and cotton seed oil extraction factories against minimum standards prescribed for the purpose ¹²	Provincial Government (Agriculture Department)/Cotton Inspectors
Maintaining varietal purity	Prohibition of specified varieties of cotton in notified areas	EDO (Agriculture)/ Cotton Inspectors/Railway officers
	Restriction of transport of prohibited varieties of cotton from specified areas	
	Registration of seeds	Federal Seed Certification and Registration Department Cotton Inspectors
Marking of bales	Marking of cotton bales ¹³	Ginners/cotton inspectors
Grading/Standardization	Gradation and standardization ¹⁴	Provincial Government/Pakistan Cotton Standards Institute
	Placement of cotton graders and classers in Cotton ginning factories	Pakistan Cotton Standards Institute Karachi
Better farming/picking/storage	Restriction on sowing of certain varieties of cotton	Provincial Government cotton inspectors

¹² See section 15, Cotton Control Ordinance, 1966 and section 9, Cotton Ginning and Factories Act, 1925

¹³ Section 4, 14, Cotton Ginning and Pressing Factories Act, 1925

¹⁴ Section 27, Cotton Control Ordinance, 1966

Broad area	Nature of action/compliance	Enforcement by
age practices to prevent cotton contamination	Use of certified seeds only	Federal Government Provincial Government/Seed inspectors
	Prohibition of collection of cotton in non-cotton bags etc	Cotton Inspectors/courts
	Prohibition on admixture, adulteration, contamination, watering etc of cotton	Provincial Government/courts
Collection of statistical information/Documentation of cotton/cotton seed production		
Registration	Registration of Ginning factories	Provincial Government/cotton inspectors
	Registration under the Sales Tax Act, 1990	Federal Board of Revenue
Filing of information/returns	Filing of returns ¹⁵	Pakistan Central Cotton Committee/Cotton Inspectors /provincial government (for publication of statements showing the total number of bales pressed in the Province)
Regulation of trade in cotton		
International trade	Use of Standard weights and measures	Provincial Government Cotton inspectors
	Classification and gradation of cotton	
	Marking of cotton bales	
	Purchase of cotton to fulfill international trade obligations	Cotton Board

¹⁵ See section 3, Cotton Ginning and Pressing Factories Act, 1925

Broad area	Nature of action/compliance	Enforcement by
Local trade	Fixation of prices ¹⁶	Provincial Government
	Movement prohibitions ¹⁷	Railways/courts
Research in Cotton		
Promotion of cotton research	Imposition and collection of cotton cess on cotton exported from Pakistan or consumed in any mill in Pakistan for purposes of research	Imposition and collection of cess- Collector of Customs; Research- Pakistan Central Cotton Committee/various research institutions
Collection of revenues		
	Registration	Collector of Customs/ Sales Tax; Provincial Directorate of Excise and Taxation etc
	Maintenance of record	
	Collection of sales tax	
	Collection of cotton ginning tax	
	Collection of cotton cess	

Enforcement can be improved by having a detailed look at regulations with regard to intrinsic problems related to enforcement, the ability of staff to undertake enforcement and independent monitoring of enforcement frequency/focus.

3.2 Legal issues

The major legal issues with the current framework are as follows:

a) Archaic statutes

¹⁶ Section 26, Cotton Control Ordinance, 1966

¹⁷ Section 22-24, Cotton Control Ordinance, 1966; section 3, Cotton Transport Act, 1923

As can be seen from the survey of the regulatory and legal framework, the mainstay statutes are more than fifty years old and not in sync either with current market conditions or modern regulatory practices in the area. The laws should be amended to reflect current thinking on the subject.

b) Excessive number of legislative enactments

The number of enactments exclusively dealing with the cotton value chain is seven. In addition to these five other statutes deal with cotton as a seed, plant, agricultural produce or taxable commodity. In addition to the seven applicable statutes there are two others – the Cotton Cloth Act and the Cotton Ginning (Control and Development) Act, 1976, which are now of historical interest only. This is a large number and consolidation will lead to simplicity, ease of understanding, improved enforcement, and removal of overlaps and inconsistencies.

c) Presence of unnecessary detail in enactments

As can be seen from the regulatory and legal survey the two main laws, which deal with cotton ginning- the Cotton Control Ordinance and the Cotton Ginning and Pressing Factories Act provide too much detail especially with regard to technological and structural requirements. Such requirements are best issued as part of rules so that they can be amended with ease and the law is able to keep pace with improvements in technology.

I. Unclear/inappropriate regulation responsibilities

As can be seen, some laws place regulation responsibilities inappropriately. For instance persons in the transport business have been saddled with responsibilities to check and stop cotton varieties and cottonseed when they are unequipped to identify cotton varieties or cottonseed¹⁸. Inappropriate regulation responsibilities should be removed and provisions, which are difficult to enforce should be deleted.

3.3 Recommendations

The state of regulation clearly indicates the way reform needs to take.

- A.** The focus of regulation needs to shift from maintaining varietal purity to adequate labeling and disclosure. Enforcement of labeling provisions can be undertaken in one of the following three ways:
 - a) *Labeling provisions without incentive arrangements/coercive enforcement (voluntary labeling): Labeling provisions not backed by incentives and/or penalties are not likely to be adhered to unless premiums are paid at every level of the value chain. However in the current state of the market premium is unlikely to be paid unless fixed by law/executive order. However price fixations are best avoided and remain difficult to enforce.*
 - b) *Labeling provisions accompanied by coercive enforcement: Coercive enforcement is generally a low cost method of modifying market behavior. However in a market where quality*

¹⁸ See section 22, Cotton Control Ordinance, 1966

products are vastly outnumbered by low quality produce, ginners are likely to resist labeling, as it will reduce their profit margins. Further coercive enforcement comes with its attendant problems – huge enforcement bureaucracy, resistance, rent seeking, etc.

- c) *Labeling provisions with incentives: In an environment characterized by weak rule of law the best way forward is provision of incentives for labeling. These incentives can take the shape of monetary payouts to complying ginners, subsidizing costs of labeling, reduced interest/no interest loans for lint cleaning machinery and reduced taxes and levies.*
- B.** While law should continue to encourage technological improvements/machinery upgrades, there is no one fixed way to achieve this objective. The various options in this regard are as follows:
- a) Intrusive regulation requiring infrastructural and technological compliances in ginning factories
 - b) Incentives for compliance including provision of loans/reduced taxes/establishment of pricing mechanisms
 - c) Consolidation of ginning factories

Benefits and downsides of these options are similar to labeling provision options. For instance intrusive regulation is not effective and leads to discontent and agitation while incentives require financial outlays. However Government can avoid financial outlays by making spinners pay for improvements through the cotton cess fund, especially where spinner behavior is considered to be the major cause of lack of labeling, good ginning practices, poor technology in ginning factories. The option of consolidation on the other hand is a way to make businesses pay/provide for their own upkeep, technological needs and liquidity requirements. Such a route is frequently adopted in financial markets. Cotton ginning work in Pakistan is, however done by people who are unwilling to corporatize and are likely to resist corporatization requirements and/or fixing high capital requirements for the same.

- C.** On farm regulation, while important for contamination control, is extremely difficult to enforce through policing and this aspect of regulation should be achieved through voluntary certification only. Again voluntary certification can be done through government appointed inspectors or private sector entities although this report supports certification through private certification agencies for efficiency and effectiveness reasons.
- D.** Registration/information rendering requirements need to be rationalized and multiple use of information encouraged. Multiple use of information can be made possible by legally providing information that needs to be rendered and collected, entrusting collection/maintenance responsibilities to one institution and notifying departments/entities that may access information from the relevant database(s).
- E.** A number of institutions like the Pakistan Cotton Board and the Provincial Cotton Control Board should be abolished.
- F.** As cotton research is a public good it should be funded from budget appropriations and the cotton committee should be restructured as the cotton research board. As proposed in earlier

paragraphs, cotton cess should be used for technological improvement of the recalcitrant cotton ginning industry and not for varietal improvement.

- G.** Laws need to be consolidated and their number reduced with consolidation effected at both the federal and provincial levels¹⁹. The ideal number of laws is three – two at the federal level and one at the provincial level with the federal laws dealing with cotton research and cotton standardization respectively and the provincial law dealing with labeling, disclosures, technological compliances, record keeping and taxation.

¹⁹ (FIRMS Project , March 2 2011)

Appendix II: Literature reviewed/cited

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Appendix III: Laws/rules reviewed

1. Cotton Transport Act, 1923
2. Cotton Ginning and Pressing Factories Act, 1925
3. Cotton Industry (Statistics) Act, 1926
4. The Oilseeds Committee Act, 1946
5. Imports and Exports Control Act, 1950
6. Pakistan Cotton Act, 1957
7. West Pakistan Cotton Control Ordinance, 1966
8. West Pakistan Cotton Control Rules, 1966
9. Pakistan Seed Act, 1976
10. Pakistan Plant Quarantine Act, 1976
11. Agriculture Produce Markets Act, 1978
12. Export Policy and Procedures Order, 2000
13. Cotton Standardization Ordinance, 2002
14. Special Procedure for Ginning Industry Rules, 1996

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