

POLICY ISSUES FOR ECONOMIC GROWTH IN THE MACRO-ECONOMY, ENERGY, AND AGRICULTURE¹

A. INTRODUCTION AND SUMMARY

This paper provides a short-list of the main areas and issues for policy intervention in selected areas of the Pakistan economy². CSF has been working primarily in the areas of investment strategy, industrial manufacturing and agriculture and the policy interventions are mainly ones currently being tackled by CSF (e.g., for Mid-term Investment Strategy, Special Economic Zones, motorcycle exports, wheat–flour industry, edible oils, food safety). Energy analysis is based on secondary sources. Macro-economic policies form the context for competitiveness and have been analyzed through the prism of CSF’s State of Pakistan’s Competitiveness Report 2008).

The main areas of the economy requested for analysis are:

1. **Macro-economy** (including private sector development, investment and trade)
2. **Energy** (including main thermal, hydel and alternative sources)
3. **Agriculture** (including agribusiness, food security and nutrition)

The approach taken to identifying these policy issues is “geo-economic” or “situational” analysis. This paper is based on the facts of Pakistan’s situation in terms of geographic location in the region, its natural factor endowment, demographics and productive base³.

The paper is intended to provide a clear/prioritized roadmap for policy intervention in the current circumstances facing Pakistan.

The top priority policy issues within these areas are:

1. Macro-economy

- Inflation and Fiscal/Monetary policy
- International Trade and Investment
- Private Sector Development ((including business environment, justice and governance)
- Industrial restructuring (including Special Economic Zones, supply chain, workforce development and gender)

¹ This paper is prepared by the CSF at the request of the USAID Mission in Islamabad and is dated 10th October 2008

² Policies are multi-faceted and complex. Each of the designated areas has multiple possible policy interventions the outcome of which is unknown. Oversimplification runs the risk of getting the wrong outcome. CSF has selected what appear to be the most important policies for USAID intervention, but these are not inclusive of all possible policies.

³ CSF has conducted research in some if not all of these areas. Detailed papers can be provided.

2. Energy

- Electricity Supply
- Energy Efficiency
- Sources of Energy (Water, coal, gas, alternative)

3. Agriculture

- Land, crops, irrigation, crop production and land reform
- Agriculture/livestock (including inputs, production, processing and marketing and infrastructure)
- Food security (especially wheat flour, rice and edible oils but also crop diversification to high-value crops)
- Food manufacturing
- food standards (safety and quality, certification, enforcement, and legislative/regulatory aspects)

This document sets out the main aspects of each of the above-mentioned topics and then provides the suggested policies and interventions.

The principle priority policies or interventions are⁴:

1. Macro-economy

- Build foreign exchange reserves.
- Limit borrowing that adds to inflation.
- Cut GoP expenditures
- Increases interest rates.
- Re-design the tax regime.
- Cut back subsidies,
- Provide export incentives within the framework of WTO agreements
- Lower domestic production costs by tackling issues in energy and infrastructure
- Improve labor productivity through vocational skills training and workforce development programs.
- Maintain a competitive exchange rate
- Improve the investment environment via (a) a Mid-term Investment Strategy, (b) Modification of the current investment law of 1976, (c) Develop commercial arbitration legislation
- Approve the SEZ Policy by the GOP
- Draft and notify the SEZ Act

⁴ This list is a very brief summary of the policy issues derived in the text that follows.

2. Energy

- Establish a facilitation body for a dialogue between the institutions dealing with energy and avoid duplication of effort ensuring the effectiveness of operations
- Establish a national water coordination body
- The demands of the Sindh (below the Sukkur dam) and Punjab must be reconciled once and for all.
- NWFP concerns about the Kalabagh Dam construction must be allayed.
- A detailed review of conventional and alternative energy and recommendations made for finding a sustainable increase in electricity supply.
- Special encouragement should be given to private energy suppliers.
- In addition the administrative and institutional aspects of electricity generation and distribution must be urgently overhauled.
- Total management and operational review of the Water and Power Development Authority (WAPDA)
- Enforce countrywide energy
- Effective enforcement of energy usage to prevent theft and “free riding” of the system.

3. Agriculture

- Agricultural research needs to be rationalized and made effective so modern crop technologies can be transferred. PARC/NARC must be given a more direct role in R&D management.
- Water use must be rationalized and coordinated
- Water-users groups must be encouraged and formal systems of pricing and cadastral rights introduced.
- Farmer cooperative groups can be encouraged via tax arrangements, business registrations, and access to finance etc.
- Outstanding legal cases relating to land awaiting judgment must be expedited.
- The issuance of land title deeds must be regularized and the influence of the “*patwari*” reduced in favor of a transparent system.
- Bt (GM) cotton must be introduced and promoted as rapidly as possible.
- The propagation systems for GM seeds must be in place to ensure that the purity of the seed is maintained.
- A Cotton and Textile Industry Task Force on a public-private partnership basis should be established to deal with restructuring the industry.
- Review the structure of the wheat industry.
- The farm wheat support price must be based on production costs and margins.
- Intervention in wheat by federal and provincial agencies should be reduced as far as possible
- Inefficiencies in the supply and value chain must be reduced.

- A private-sector operated and financed storage and supply system must be built.
- The “subsidy”-quota system in the flour milling industry must be abolished and this sector of the industry rationalized.
- Physical restrictions on the movement of wheat and flour should be reduced as a first step to removing the distortions in the market.
- Provide a production-cost based price support for sugarcane
- Coordinate farm production with sugar milling demand and capacity and lower the cost of refined sugar
- Grow sugarcane for bio-fuel as well as for refined sugar
- Promote local oilseeds on a production-cost and efficiency basis. These crops can include canola (rapeseed), sunflower seed (in drought areas), olive trees (in upland areas of the north and west).
- Encourage the processing sector to upgrade technology and move into value-added refining and product manufacturing.
- Food manufacturing should be focus of the government's manufacturing and industrial strategy.
- Multinational companies must be encouraged to bring their advanced food technology to Pakistan and to establish joint-ventures with local companies based on technology transfer.
- Local light engineering companies must be assisted to understand and build the latest designs of machinery.
- Financial products must be developed for food manufacturers that help them manage the seasonal risk of raw material supply.
- Restructure the Pakistan Quality and Standards Authority (PQSA) to include food items (fresh, processed or manufactured) as a major priority
- Increase the number of food items on the PQSA Inspection list through notification
- Build the National Animal and Plant Health Inspection Services (NAPHIS) into an agency capable of across the board enforcement of food standards.
- Establish a clearly recognizable “Brand Pakistan” that sets the benchmark for quality.
- Implementation of the National Trade Corridor Project (for cool chains) ← ?
- Interventions at the horticulture industry level with regard to certification for exports, introduction of new cultivars and high yielding seeds, post harvest processing (e.g., for second grade fruit into juice).

B. POLICY ISSUES FOR ECONOMIC GROWTH IN PAKISTAN

1. Macro-economy

Pakistan is heading towards an economic and financial meltdown. Macroeconomic indicators are pointing towards a default and a deep economic crisis. CSF's "State of Pakistan's Competitiveness report 2008" notes that the country's competitiveness has worsened, Standard & Poor's has downgraded Pakistan's credit rating from B+ down to CCC+. The private sector is faltering and the Pakistan's business environment has been identified as a major constraint on economic growth.

a. Inflation and Fiscal/Monetary Policy

In February 2008 the SBP announced that "*the risk to inflation outweighs the risk to growth*". Accordingly the discount rates were increased; it is probable that further hikes can be expected. Reserve ratios were also increased to decrease the amount of money flowing through the economy in an attempt to dampen inflation. The State Bank has also launched work on a new "Central Bank Law" that provides greater autonomy and accountability of financial institutions under its oversight this law should come into effect by 2010.

The stress on the fiscal account is very high. In 2004 the budget deficit was 2.4% of GDP by 2008 it had increased to 7% of GDP and similarly the current account deficit was 8% of GDP. There have been significant underestimations as regards to the costs of associated with recurrent expenditures including interest payments and excessive subsidization of oil and food products that grew from Rs114 billion budgeted level to Rs407 billion as the Government opted to delay the end of subsidies associated these products. The inability of the Government to tap non-bank and external sources of funds has made the GoP rely heavily on the Bank of Pakistan for funds. The impact of this excess liquidity is serious for the inflation outlook, as this has added to the currency in circulation and diluted the tight monetary policy stance of the Central Bank.

The GoP needs the help of international donors to shore up its accounts, but it also needs to address the crisis in confidence in Pakistan's economy so it can stop borrowing from its central bank, the SBP.

Policy Issues:

- The first step to increasing the confidence in the economy will be an effort by the GoP to get donor help for building up foreign exchange reserves; attempts in this direction have already been made.
- The SBP has been doing all it can to keep a cap on inflation. The GoP and the Bank have to make a firm joint commitment to limit borrowing that adds to inflation.

- Another critical issue is a legacy of excess demand, a direct impact on price inflation, left by the previous government and exacerbated by the expansive budget of the current government. The GoP needs to cut expenditures across the board whilst the SPB increases interest rates. Short/Medium term economic growth will slow significantly but the long term health of the economy will benefit.
- The tax regime in Pakistan needs to be redesigned; currently the ratio of tax to GDP is 10%. This low number is a result of an outmoded tax regime that does not reflect the realities of the changing economy. Rationalizing the tax regime will decrease the need for borrowing and provide money for essential services both of which will prove indispensable for robust future growth.

b. International Trade

Consumption demand in 2007 outstripped domestic manufacturing capacity. Imports grew at 25% p.a. (20% excluding fuel), and Exports only 8.5% p.a., between 2005 and 2008. Even though workers remittances grew strongly through this period and there were substantial foreign direct and portfolio inflows, the trade and services gap was too large. Foreign currency reserves fell in absolute terms, from providing 9 months cover against Imports in 2004, to less than two months now.

Policy Issues:

- Domestic demand pressure must be curbed by cutting back subsidies, raising interest rates and reducing the Public Sector Development Programme.
- Export incentives can be provided both non-monetary and monetary but within the framework of WTO agreements
- Domestic production costs can be lowered by tackling issues in energy and infrastructure
- Labor productivity must be improved through vocational skills training and workforce development programs.
- A lower exchange rate is valuable except in as far as it contributes to domestic inflation

c. Foreign Investment Strategy

Pakistan has done well in previous years to attract foreign direct investment (FDI), but the direction of that investment has been towards liquid assets and

services, all easily removed when the economy turns bad. No figures are currently available on net FDI, but a large proportion of the \$5 billion that entered the country in 2007 has fled in 2008.

The SPB has tackled the capital flight issues as follows:

Policy Issues:

- Exchange companies have been required to surrender a minimum of 15 percent, instead of earlier 10 percent, of foreign currencies received by them
- Limits on advance payments that were relaxed last year have been tightened. Now advance import payments will only be allowed against letter of credits and that too only to the extent of 50 percent. Advance payments against contracts are now not allowed.
- Exchange companies have been encouraged to focus on promoting home remittances and companies can only affect outward remittances to the extent of 75 percent of the home remittances mobilized by the respective company.

Investment must be encouraged in productive, long-term and sustainable assets, into technology and science-based industry, manufacturing and agri-business.

Policy Issue:

- The groundwork has already been laid by CSF working with the Board of Investment / Investment Division and this policy needs to be supported⁵. The strategy goes hand-in-hand with the infrastructure developments noted above, especially the development of attractive SEZs (see below).

Pakistan's economy will prosper with investment in SMEs (where the need is to drastically upgrade existing processes and designs) and in larger-scale industrial units.

Policy Issues:

- Foreign investment in manufacturing must be a target to allow the eventual transfer of skills and technology to local companies.
- The GoP needs to work with donors on special investment schemes such as the Global Development Alliance (GDA) that channels US Government aid through large companies and the private sector.

⁵ A Summary has been moved for Prime Minister's approval

d. Special Economic Zones/ Reconstruction Zones

Special Economic Zones and Public Private Partnerships can go a long way in helping to encourage FDI and induce local investors to participate in more ambitious projects⁶. At its most basic level SEZs compensate for perceived country risks by providing infrastructure and tax incentives (especially long term tax holidays). Similarly, Reconstruction Opportunity Zones (ROZ) in NWFP provide compensation to private companies that take on risk by providing a liberal export regime to the United States for all products made in the zones. PPPs also mitigate perceived risks by the fact that that private companies investing in Pakistan have the strongest possible local partner, the government, to ensure the completion and enforcements of contracts and obligations.

Policy Issue:

- There have been SEZ-like policies in Pakistan for many years, some of which are still extant today. But there has been no overarching framework to the development and regulation of these projects making them sporadic and inconsistent. This issue has been addressed at a recent meeting of the Economic Coordination Committee (ECC) where the Board of Investment, with assistance from the Competitiveness Support Fund (CSF), presented a possible future framework for SEZ policy in Pakistan. The ECC has sent an approval for the SEZ Act to the Board of Approvals and the Act is expected to be ratified on 14th October 2008

e. Private Sector Development and the Business Environment

According to the Global Competitiveness Index (GCI)⁷ Pakistan consistently fails to do well in the environment for investment and doing business. This includes the micro-aspects of governance of local companies, the red tape required to establish and run businesses and the more general failure to develop a “Brand Pakistan” that has any external credibility. Many of the issues have been outlined in CSF’s “State of Pakistan’s Competitiveness Report” 2007 and 2008.

f. Industrial Restructuring, Governance and Competitiveness

Pakistan excels at small business. Pakistani culture seems to thrive on networks and clusters and these have been notably successful in industries like sporting goods, fans, surgical instruments, footwear and furniture.

The key elements for light manufacturing are access to cheap and reliable raw materials, a skilled workforce focused on quality, up-to-date and well-maintained manufacturing processes, good products and designs that respond to market needs, access to credit and export guarantees

⁶ CSF undertook a comprehensive study of SEZ in 2007 which led to the development of the Summary currently before the Prime Minister.

⁷ Produced by the World Economic Forum of which CSF is the local partner.

Policy Issues:

- The GoP must encourage existing initiatives
- The lead must be given to the private sector, for example through grants for common facility centers, design centers and the like. Industry associations must be encouraged perhaps via tax breaks given to participating companies. CSF has shown the lead in this respect by the introduction of rebates to motorcycle manufacturers for R&D that returns \$50 for every machine exported.

Legislation and governance affecting business have been identified as major constraints. In particular access to the justice system and the transparent application of commercial law are important.

Policy Issue:

- Introduction of an international commercial arbitration regulations and a mechanism for conflict resolution is essential

2. Energy

Energy supply is a key constraint to all sectors of Pakistan's economy. The sector is highly distorted on both demand and supply sides. Pakistan requires an integrated energy strategy and an integrated institutional approach to dealing with policy and implementation. The efficient use of the large natural resource endowment (water, coal, oil and gas) is critical in Pakistan.

a. Electricity Supply

The electricity shortfall has hit the record level of 7,075 MW owing to the forced shutdown of more than 24 units of power generation plants following severe fuel scarcity, WAPDA is facing 5750 MW electricity shortfall within its own system whereas 1325 MW shortfall was recorded from IPPs. The failure of the electricity supply in 2008 has been a disaster for all sectors of Pakistan's economy. The supply must be augmented by every means possible within the limits of the budget.

Policy Issues:

- A detailed review of conventional and alternative energy must be urgently undertaken and recommendations made for finding a sustainable increase in electricity supply.
- Special encouragement should be given to private energy suppliers. In addition the administrative and institutional aspects of electricity generation and distribution must be urgently overhauled.

b. Electricity Efficiency

Pakistan could see increased power shortages by 2010 unless actions are taken to increase electricity generation and reduce transmission losses. Losses are the difference between units sold/generated and purchased. Such losses significantly reduce WAPDA's finances and restrict investment. WAPDA's financial position severely restricts its ability to purchase fuel, hence the shortfall noted above. IPPs are forced to shut down because WAPDA cannot pay them.

By one estimate of Pakistan's private energy systems, thermal efficiency in energy generation system tends to be around 32-35% when the global average is around 54%. We could thus have a 60% improvement in energy generation by simply switching to newer production technologies. Distribution losses in these systems tend to be around 23%, whereas the technical losses should be no more than 3%. By this estimate Pakistan could increase its energy availability by a staggering 80% simply through more efficient distribution systems that could be updated at a fraction of the cost of mega-energy generation projects being proposed.

Policy Issues:

- There must be a total management and operational review of the Water and Power Development Authority (WAPDA) in order to reduce losses from the system.
- Enforce countrywide energy audits - The first step to solving any technical problem is to have a better estimate of the status quo. At present there is hardly any data available on the energy performance of Pakistan's industry. Therefore a detailed audit of industries and households in urban and rural areas is needed.
- There needs to be effective enforcement of energy usage to prevent theft and "free riding" of the system. The government has begun to enforce laws against such thefts but considerably more compliance assurance is needed through police action and prosecution where necessary.

Furthermore high levels of toxic emissions and a lack of energy efficiency standards need to be addressed via regulations introduced by the Government including a Monitoring and Evaluation Program for the above.

c. Sources of Energy

(i) Alternative Energy

The use of clean energy technologies—that is, energy efficient and renewable energy technologies (RETs)—has increased greatly over the past several decades. Technologies once considered quaint or exotic are now commercial realities, providing cost-effective alternatives to conventional, fossil fuel-based systems and their associated problems of greenhouse gas emissions, high operating costs, and local pollution. The GoP published an energy report, 'Policy for the Development of Renewable Energy for Power Generation' in 2006. The report proposes mainstreaming renewable energy in Pakistan by incorporating small hydropower, wind and solar technologies into development plans.

Small renewable energy projects will be able to decide how much to charge consumers for the electricity, without deferring to Pakistan's national energy authority. Wind and solar projects, irrespective of size of the plant will be dealt with by the Alternate Energy Development Board — created by the government in 2003 to facilitate and promote development of renewable energy in Pakistan.

Policy Issues:

- The GOP must work with a number of different agencies to broaden the sources of supply of electricity. In particular, the Northern areas supply can be increased through small village electrification through small scale hydroelectric potential.

Reduce the import duties across the board on imported photovoltaic cells, related equipment and parts for windmills, biogas or energy from solid waste, and even nuclear energy technology

(ii) Water

Management of the water resource in the Indus River System (IRS) is the single most important natural resource issue to be tackled. The IRS provides the world's largest and possibly least efficient irrigation system. It also provides hydro-power. Often the two requirements are in conflict because of different release times.

Policy Issues:

- Establish a national water coordination body that has an overriding power to decide issues taking into account the needs of the energy sector, industry agriculture and civil needs.
- In particular the demands of the Sindh (below the Sukkur dam) and Punjab must be reconciled once and for all. Sindh suffers from a lack of water for agriculture; this cannot be allowed to continue since valuable agricultural land is being lost at a fast rate. NWFP concerns about the Kalabagh Dam construction must be allayed.

Production of hydropower has been sidelined by the government for years, if the government had properly exploited hydropower; the country could now be enjoying a 5,000 megawatt power supply from the Kunhar-Neelum-Jhelum river system in Azad, Kashmir, adding that more hydropower projects would also reduce the cost of electricity.

In 2001, the Water and Power Development Authority of Pakistan identified 22 sites for launching hydropower projects to meet the ever-increasing demand for cheap power. It indicated that about 15,074 megawatts could be generated on the completion of these projects, which would also meet the water irrigation requirements for the growing agriculture sector.

Policy Issues:

- Large hydroelectric generation projects should be considered under the guidelines provided by the World Commission on Dams.
- Provide incentives to the private sector to construct small-scale hydel schemes as they have the advantage of being more flexible to engineering redesign or removal if necessary as they age.

(iii) Gas

The price of natural gas has increased by more than 30% since July 2008. Pakistan's largest gas field (Dera Bugti) is threatened by violence from Baloch nationalists. The industry has warned that the country might face a severe gas crisis in five years if more reservoirs are not discovered. Demand has significantly increased because of a switch to CNG gas for cars.

Policy Issues:

- An entire policy review of this sector of the industry is required.

(iv) Coal

There are huge reserves of coal in the provinces of Sindh and Punjab. The quality is good and this coal can be a better substitute than high-priced oil imported from the Middle East. Tariffs remain a point of contention between the sponsors of coal based power projects and NEPRA. Under the Power Policy 2002, competitive bidding process is time consuming and takes two years to conclude with high up-front costs to potential investors.

Policy Issues:

- The efficient use of coal on an industrial level needs to be encouraged
- Pakistan must establish institutional linkages with China to benefit from their extensive R&D program to develop cost effective and environment friendly technologies involving coal as fuel.
- Power plants should be coal-fired and all industries that need fuel for heating purposes, such as cement factories, should use coal.
- A cost based pricing formula which should form basis for competitive bidding on the tariff.
- A ministerial level Commission for the development of coal which should not only serve as a think tank for the formulation of strategic plans and policies but also should serve as one window facility and a high powered decision making body for the speedy implementation of coal mining and power projects

(v) Oil

The combination of rising oil consumption and flat oil production in Pakistan has led to rising oil imports from Middle East exporters. A lack of refining capacity leaves Pakistan heavily dependent on petroleum product imports. Import of the crude oil and oil based product put a lot of burden on the economy. There are

currently five major oil refineries operating in Pakistan which are not able to meet the demand requirements,

Policy Issues:

- Indigenous resources of gas, coal and hydro should be properly utilized for power generation. These resources should be actively promoted to reduce dependence on imported crude oil, and to reduce heavy burden on foreign exchange resources.
- Refineries face severe problems in transportation of oil from ports. More options of transportation of crude from ports should be available for refineries. Government policy of using the locally available crude at any cost should be techno-economically evaluated.

3. Agriculture⁸

Agriculture is the key driver for economic growth in Pakistan. The cotton crop provides the raw material for an industry that represents 60% of GDP. Wheat is the major source of carbohydrate and milk is essential in the Pakistani diet; livestock store wealth and provide income for women. In this case no economic growth program can avoid or should avoid being involved in the agricultural sector.

a. Land, irrigation, crops and land reform

Agriculture in Pakistan is inefficient. Crop yields are low by world standards. Production is on small plots and a high proportion of the rural population is landless, share-croppers or otherwise disenfranchised (e.g., cannot access formal finance). Crop technologies are often out-dated. Marketing channels are complex and often reduce farmers' ability to gain the true value of their production.

Access to irrigation water is a critical element for much of agriculture in Pakistan, There is disconnect between the use of the Indus River System for hydel and for irrigation. Water is not priced adequately and there are limited if any formal water rights or a mechanism for trading such rights.

The land tenure system in Pakistan is a major constraint to agricultural production. The transfer of land from inefficient holders to those willing and able to make investments in agriculture or industry can be improved, then so will output from this resource.

Policy Issues:

- Agricultural research needs to be rationalized and made effective so modern crop technologies can be transferred. PARC/NARC must be given a more direct role in R&D management.
- Water use must be rationalized and coordinated via an inter-departmental Task Force; water-users groups must be encouraged and formal systems of pricing and cadastral rights introduced.
- Farmer cooperative groups can be encouraged via tax arrangements, business registrations, and access to finance etc.
- Outstanding legal cases relating to land awaiting judgment must be expedited.

⁸ CSF has undertaken a number of detailed studies in agriculture including on the competitive advantage of food processing, focused on quality and standards, on the Karachi Fish Harbour, on horticulture and on meat and livestock.

- The issuance of land title deeds must be regularized and the influence of the “*patwari*” reduced in favor of a transparent system.

b. Cotton and Textiles

Cotton and textiles account for about 60% of Pakistan's GDP. Cotton yields are not keeping pace with the rest of the world (especially China). There is an urgent need for a restructuring of the gins and textiles mills. Unless this is done, the industry in Pakistan will collapse in the face of competition from elsewhere.

Policy Issues:

- Bt (GM) cotton must be introduced and promoted as rapidly as possible. The propagation systems must be in place to ensure that the purity of the seed is maintained.
- A Cotton and Textile Industry Task Force on a public-private partnership basis should be established to deal with restructuring the industry.

c. Wheat⁹

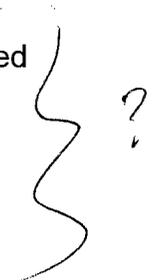
The wheat policy of the GoP is aimed at increasing wheat productivity (yields) and output, as well as supporting farmer incomes. Increased wheat production has also been seen as part of an overall national food security strategy of reducing dependence on food imports. On the consumption side, the government has attempted to enhance household food security, particularly through ensuring availability of wheat flour at affordable prices and maintaining price stability through subsidies and price controls. Currently the Asian Development Bank has succeeded in gaining agreement for partial changes in wheat policy.

Policy Issues:

- The Government of Pakistan must urgently review the structure of the wheat industry.
- The farm support price must be based on production costs and margins. An import parity support price (as proposed by ADB) will not produce the right results.
- Intervention by federal and provincial agencies should be reduced as far as possible as consistent with a fact-based calculation of food security.
- Inefficiencies in the supply and value chain must be reduced. A private-sector operated and financed storage and supply system must be built.

⁹ CSF has undertaken a comprehensive study of the wheat-flour industry

- The “subsidy”-quota system in the flour milling industry must be abolished and this sector of the industry rationalized.
- Physical restrictions on the movement of wheat and flour should be reduced as a first step to removing the distortions in the market.



d. Sugar

Sugar is produced inefficiently and at high cost. Crop technology in sugar (as for cotton and wheat) needs to be reviewed and upgraded, The sugar industry, especially the milling and processing sector needs a complete review and restructuring. The sugar industry consistently fails to provide incentives to farmers to expand production and fails to maximize the use of an extremely versatile raw material. In an era of high oil prices, the GOP needs to develop a policy for bio-fuels that makes the best use of specialty crops and includes with them sugarcane.

Policy Issues:

- Provide a production-cost based price support
- Coordinate farm production with milling demand and capacity and lower the cost of refined sugar
- Grow sugarcane for bio-fuel as well as for refined sugar

e. Edible Vegetable Oils¹⁰

Pakistan produces only a minor proportion of its requirement for vegetable oils from local sources. Cottonseed is the main local raw material and is a by-product of the cotton ginning industry. The supply is variable because (as indicated above) the industry is poorly structured. Efforts to develop other oilseed crops such as rapeseed/canola and sunflower seed have been only partially successful. Nevertheless, the country faces an increasing import bill as the price of imported Malaysian and Indonesian palm oil climbs.

Policy Issues:

- Promote local oilseeds on a production-cost and efficiency basis. These crops can include canola (rapeseed), sunflower seed (in drought areas), olive trees (in upland areas of the north and west).
- Encourage the processing sector to upgrade technology and move into value-added refining and product manufacturing.

¹⁰ CSF is starting research work on this sector

f. Horticulture¹¹

Pakistan is blessed with a huge variety of fruits and vegetables. Flowers are also a major and neglected element in the horticulture industry.

The GOP has made a clear selection of the priority fruits and vegetables that it wishes to promote, especially for export. These are:

<u>Fruits</u>	<u>Vegetables</u>
Mango (Punjab & Sindh)	Onion (Balochistan & Sindh)
Citrus (Punjab & NWFP)	Potato (Punjab & NWFP)
Dates (Balochistan, Sindh & NWFP)	Cabbage (NWFP)
Apple (Balochistan & NWFP)	Chillies (Sindh and Punjab)
Other stone fruit (e.g., apricots)	Tomatoes (Northern areas)

Policy issues:

- Possible finance policy interventions and the development of a so-called Partial Credit Guarantee Scheme
- Restructuring of the quality and food standards agencies in MinFAI and related provincial departments of agriculture
- Implementation of the National Trade Corridor Project (for cool chains)
- Interventions at the industry level with regard to certification for exports, introduction of new cultivars and high yielding seeds, post harvest processing (e.g., for second grade fruit into juice). This element will be extensive and tie into projects being developed e.g., by ADB for primary marketing.

g. Livestock¹²

Pakistan is home to one of the worlds' largest herds of livestock, the Pakistani people do not consume much meat. There are various explanations of this phenomenon: one is that the herd is kept for milk production – and Pakistanis do consume a very large amount of milk. The dairy industry has been extensively developed with initiatives from USAID under the PISDAC project. The meat sector is largely traditional and depends on ad hoc arrangements.

- GOP policy has been to support the traditional sector with veterinary services and to encourage commercial farming. The policy is in place and requires no intervention.

¹¹ CSF assisted Ministry of Finance and MinFAL in establishing a Task Force on Horticulture Finance and Competitiveness

¹² CSF has an on-going analysis of this sector

h. Food Manufacturing

Much emphasis has been placed on the role of agriculture in moving the economy forwards. However it must be re-emphasized that wheat, sugar, vegetable oils and other agricultural goods are merely raw materials. Pakistan must move rapidly from considering itself an agricultural country to seeing itself as one of the world's larger manufacturers of food. Pakistan should be exporting high-value crops and food products. It should also be able to provide itself with fruit juice and to export premium quality meat and dairy products, especially to the Muslim world that requires *halal* foods.

Food manufacturing (including dairy, meat, fish and horticulture-based products) goes hand-in hand with many of the elements considered vital in this strategy. Food processes cannot sustain poor quality water, high levels of wastage from poorly cultivated and handled raw materials, failure of the electricity supply, lack of cool chains and delays at the port or airport. By the same token, a country that can develop a vibrant food processing industry can, because of its complexity and the requirement for the highest of all management and manufacturing standards will usually become successful in other areas.

Policy Issues:

- Food manufacturing should be focus of the new government's manufacturing and industrial strategy.
- Multinational companies must be encouraged to bring their advanced food technology to Pakistan and to establish joint-ventures with local companies based on technology transfer.
- Local light engineering companies must be assisted to understand and build the latest designs of machinery.
- Financial products must be developed for food manufacturers that help them manage the seasonal risk of raw material supply.

i. Nutrition, Quality and Standards¹³

Pakistan signally fails in every respect to encourage or impose high standards of quality in its manufactured goods (including food). In some respects, poor quality is the quintessential Pakistani failure and perhaps the real reason that the economy fails to be competitive. As mentioned, at the domestic level, food hygiene is poor or non-existent. In manufacturing, few manufacturers achieve CEC certification or meet ISO standards. The government bureaucracy pays lip-service to quality, but has failed to grasp the need not only to have the required laws and regulations but to ensure their enforcement.

¹³ CSF has undertaken extensive work at the Karachi Fish Harbour

Policy Issues:

- Restructure the Pakistan Quality and Standards Authority (PQSA) to include food items (fresh, processed or manufactured) as a major priority
- Increase the number of food items on the PQSA Inspection list through notification (e.g., currently does not include carbonated drinks)
- Build the National Animal and Plant Health Inspection Services (NAPHIS) into an agency capable of across the board enforcement of food standards.
- Establish a clearly recognizable “Brand Pakistan” that sets the benchmark for quality.