AGRICULTURAL POLICY ANALYSIS PROJECT, PHASE II

Under contract to the Agency for International Development, Bureau for Research and Development, Office of Agriculture
Project Office Hampden Square, 4800 Montgomery Lane, Suite 600, Bethesda, MD 20814 • Telephone: (301) 913-0500
Telex: 312636 • Fax: (301) 652-3839

FINANCIAL AND OTHER POLICY CONSTRAINTS TO AGRIBUSINESS DEVELOPMENT IN PAKISTAN

December 1992

APAP II
Collaborative Research
Report No. 344

Prepared for

Agricultural Policy Analysis Project, Phase II (APAP II)
A.I.D. Contract No. DAN-4084-Z-11-8034-00

Authors: Gary P. Ender
Imran Ali
Kenneth Smarzik

Prime Contractor: **Abt Associates Inc.**, 55 Wheeler Street, Cambridge, MA 02138 • (617) 492-7100

Subcontractors: **Harvard Institute for International Development**, Harvard University, One Eliot Street, Cambridge, MA 02138 • (617) 495-9779
Food Research Institute, Stanford University, Stanford, CA 94305-6084 • (415) 723-0693
North Carolina State University, Department of Economics and Business, Box 7645, Raleigh, NC 27695-7645 • (919) 515-3107
Abel, Daft & Earley, 1410 King Street, Alexandria, VA 22314 • (703) 739-9090
International Science and Technology Institute, 1129 20th Street, NW, Suite 800, Washington, D.C. 20036 • (202) 785-0831
International Food Policy Research Institute, 1200 17th Street, NW, Washington, D.C. 20036 • (202) 862-5600

TABLE OF CONTENTS

LIST OF TABLES

LIST OF FIGURES

LIST OF ACRONYMS

ABC	AgriBusiness Cell, MINFAC
ABL	Allied Bank of Pakistan Limited
ACSCA	Analysis of Corporate Sector Constraints in Agriculture (Project)
ADB	Asian Development Bank
ADBP	Agricultural Development Bank of Pakistan
AFIC	Asian Finance and Investment Corporation
APAP II	Agricultural Policy Analysis Project, Phase II
ASSP	Agricultural Sector Support Program
BEL	Bankers Equity Limited
BMR	balancing, modernization, and rehabilitation
BOP	Bank of Punjab
CEC	Cotton Export Corporation
CKD	completely knocked down (disassembled)
CLA	Corporate Law Authority
DAP	Diammonium Phosphate
DFI	Development Finance Institution
EPU	export processing unit
EPZ	export processing zone
ESOP	employee stock ownership plan
FBC	Federal Bank of Cooperatives
FWBL	First Women Bank Limited
GCP	Ghee Corporation of Pakistan
GNP	gross national product
GOP	Government of Pakistan
HBFC	House Building Finance Corporation
HYV	high-yielding variety
ICP	Investment Corporation of Pakistan
IDBP	Industrial Development Bank of Pakistan

IFAD	International Foundation for Agricultural Development
IFC	International Finance Corporation
IMF	International Monetary Fund
IRRI	International Rice Research Institute
KSE	Karachi Stock Exchange
LDC	less developed country
LMM	locally manufactured machinery
LUMS	Lahore University of Management Sciences
MCB	Muslim Commercial Bank
MINFAC	Ministry of Food, Agriculture, and Cooperatives
NBFI	non-bank financial institution
NCB	Nationalized Commercial Bank
NCCC	National Credit Consultative Committee
NDA	National Disinvestment Authority
NDFC	National Development Finance Corporation
NDLC	National Development Leasing Corporation
NFC	National Fertilizer Corporation
NFML	National Fertilizer Marketing Limited
NRIS	non-repatriable investment scheme
PASSCO	Pakistan Agricultural Storage and Services Corporation
PBC	Pakistan Banking Council
PIA	Pakistan International Airlines
PICIC	Pakistan Industrial and Credit Investment Corporation
PIDC	Pakistan Industrial Development Corporation
PPCBL	Punjab Provincial Cooperative Bank Limited
RDFC	Regional Development Finance Corporation
REC	Rice Export Corporation
SBFC	Small Business Finance Corporation
SBP	State Bank of Pakistan
SOE	state-owned enterprise

UHT	ultra-high temperature (re milk)
UNDP	United Nations Development Program

PREFACE

In the course of its technical assistance activities, USAID/Pakistan has supported a substantial amount of research on agricultural policies in Pakistan. Many of these studies have significant implications for agribusiness policy as well, but until recently agribusiness was not a major focus for the Mission.

Since 1989, APAP II has assisted the Mission in the conduct of its agricultural policy dialogue with the GOP, during which much valuable knowledge and experience has been gained. This experience with both policy research and implementation provides part of the basis of APAP II's assistance to the Government of Pakistan and USAID/Pakistan in this study. By making recommendations on which the Government can take immediate or near-term action, APAP II hopes to contribute to the ongoing economic reforms in both the public and private sectors.

EXECUTIVE SUMMARY

The objectives of this study are to identify current constraints to agribusiness development and to recommend further actions needed to improve the environment for investments in this sector. Considerable policy analysis and experience have resulted from the policy dialogue which the Government and USAID have conducted under the Agricultural Sector Support Program (ASSP), with support from APAP II. The study builds on this knowledge, the results of the ACSCA project, and other USAID-funded studies.

There is concern in Pakistan that the growth of agribusinesses is constrained by a lack of working capital. However, Pakistani financial institutions assess the working capital needs of businesses in the same manner as commercial banks across the world. Their manner of securing their loans are also the same, taking not only a pledge of inventory, but also liens on other assets, preferably fixed ones, such as land and buildings. Bankers and clients both in Pakistan and elsewhere often disagree over how much working capital is needed to efficiently operate a particular business. Perishable inventories and difficulties in managing working capital complicate the assessment of need for and shortage of working capital. The shortage of working capital is most acute in small and medium-sized agribusinesses.

The manner in which the GOP controls money supply was examined. In the past, due to high reserve requirements and directed credit programs (35% and 10% of total banking assets, respectively), the availability of capital for on-lending to the private sector was, at the least, being constrained. These policies also effectively controlled interest rates, which then left bankers with no incentive to pursue higher-risk ventures. Rather they chose to keep their excess funds in government securities or loan them to low-risk, large, family corporations. This situation was aggravated by low-markup credit schemes that were to go for specific socioeconomic purposes. The low cost of this fungible capital made it attractive, and it found its way into businesses for which it was not intended.

It is recommended that the Government continue its efforts to introduce competition into the banking system and gradually eliminate directed credit and credit schemes, as provided for under the IMF agreement. The AgriBusiness Cell should continue to identify the constraints to the expansion of the agribusiness industry and promote a debate or commission a study on what constitutes a productive subsidy to agribusiness in Pakistan. The Government should instruct DFIs not to remove working capital from loan applications, and it should find alternate ways to control speculation in food crops, mostly through the use of free and open markets, instead of limiting the amount of working capital that a bank can advance to an agribusiness. A project development facility should be established for small and medium-sized agribusinesses and a private DFI should be established to serve this same sector as a lead institution.

The effects of price-distorting and related agricultural commodity policies on producers and consumers are well known. These same policies can also have damaging effects on agri-businesses. They may be as perverse as encouraging the use of food grains as poultry feed.

Government intervention and domination have crowded out legitimate private sector agribusinesses in many sectors from wheat storage to ghee production. The Government has not provided consistent policies. Ad hocism hampers agribusiness investment by creating uncertainty. Meanwhile, the lack of government-promoted grades and standards lowers the quality of products available to domestic consumers and the ability of the country's exporters to be competitive in international markets.

The attitude that the middleman is parasitic must be replaced by the notion of a businessman trying to earn a profit by adding value to the product he receives in response to the needs of the consumer. Policies flowing from this attitude will encourage the development of agribusiness in Pakistan. By the same token, the private sector cannot expect the Government to provide infrastructure and other facilities that the private sector needs without the private sector's contributing fairly to the resources necessary. The private sector needs to take a more mature attitude toward paying taxes. Steps the Government can take to manifest change in attitude include switching to regulation instead of production and marketing, and steps to promote taxpaying (some of which were announced in the recent budget).

For agriculture and agribusiness, one of the most important areas of human capital is the agricultural research system, which can provide both improved crop and livestock species and new agricultural and processing machinery. The Government must consider this system a vital long-term investment, both in the sense that it must be supported consistently over a long period of time and that its benefits continue to accrue over an even longer period of time. These benefits reach farmers, agribusinesses, and consumers. Given that the Government's resources are always limited, it should also try to facilitate the private sector's involvement in research.

Pakistan's current program of privatization may have a significant impact on the conduct of agribusiness in the country. To ensure a positive effect, the momentum of the privatization program must be maintained. The privatization of the banking sector and key agribusinesses like fertilizer and ghee should be completed as expeditiously as possible. The essence of privatization is a change in the roles of the public and private sectors. The public sector needs to exert less control, but more regulation, over the markets for agribusiness goods and services. The private sector needs to learn to plan more systematically and take the needs of the consumer into account more.

Lessons learned from case studies of Chile and Thailand, countries that successfully improved the policy environment for the development of agribusiness, include the following. Winning strategies for agribusiness growth need to be commodity-specific. In this vein, the AgriBusiness Cell should continue its efforts to facilitate investment in the oilseed processing sector. A smoothly operating quality control system is of crucial importance, especially for agricultural products moving into export channels. A winning strategy for the agribusiness sector needs to pay very close attention to markets. Thus, participation of the private sector in policy dialogues is an important factor that can contribute to agribusiness development. Foreign investment can play a crucial role in accelerating growth in the agricultural sector. Foreign firms bring not only financial resources, but access to technology that may be needed to develop fully a particular comparative advantage, and in depth knowledge about export markets as well. Perhaps most importantly, winning strategies have clearly defined roles for both the public and private sectors. Specialization and cooperation were hallmarks of these examples.

In Pakistan, the structural weaknesses of agribusiness development are reflected in the inability to make a transition from family capitalism to managerial capitalism. Recommendations in this area include broader financing of agribusiness, specialized agribusiness finance, and simplifying investment procedures. The role of the government must remain an area of close evaluation. The Government should take steps to foster the development of companies, whether family-run or not, whether large or small, that function efficiently. These steps include the development of human capital and physical infrastructure (including properly trained managers) and the development and enforcement of grades and standards for both products and services (including accounting). Infrastructural development will foster the transition to managerial capitalism as agribusinesses increase in size to take advantage of larger markets.

In the area of incentives to agribusiness and other sectors, it does not appear that agribusiness is at a disadvantage with respect to other industries. On the other hand, the existing incentives do not reflect a cohesive long-term, goal-oriented strategy. Incentives often pertain to very specific sectors or industries, apparently the result of lobbying rather than a well-developed strategy. It should be noted that income tax breaks will only serve as effective incentives for agribusiness development when the government has the capacity to enforce the tax laws and collect taxes. If the tax laws are generally unenforceable and it is easy for businesses to evade taxes, tax breaks are not likely to provide much incentive to the potential investor. Thus, the Government should maintain and, where possible, redouble its efforts to broaden the tax base, and the system of direct and indirect tax incentives should be streamlined. An area where complete coverage would increase the perception of fairness is the exemption of income from agriculture from direct taxation. A way to begin to treat agriculture on an equal basis is to introduce a system of cash accounting. To encourage efficiency, moreover, financing of further ventures or expansion of existing capacity should receive credit and tax incentives similar to those presently enjoyed only by new projects of newly-formed firms.

1. INTRODUCTION

This chapter gives an introduction to the topic of agribusiness in Pakistan. In addition to this background, it provides the justification, objectives, and approach of the study. It concludes with an overview.

1.1 Background and Justification

Past governments of Pakistan have actively intervened in the agricultural sector. These interventions have included parastatal agribusiness companies engaged in production and marketing, directed credit programs, price distortions that affected the supply of farm outputs to agribusinesses, and trade restrictions that affected the ability of agribusinesses to export agricultural products.

The Government's attitude toward the roles of the public and private sectors is now changing. The Prime Minister has said that the Government should not be operating businesses. This new attitude is particularly apparent in the implementation of a privatization program and the creation of the AgriBusiness Cell in the Ministry of Food, Agriculture, and Cooperatives. The Government recently requested assistance from the USAID-funded Analysis of Corporate Sector Constraints in Agriculture (ACSCA) project for drafting an agribusiness policy. The GOP is looking for constructive actions that can be taken to promote agribusiness in the country. This provides a good opportunity for specific and tested recommendations.

Such new interest in agribusiness is deserved. Agribusiness contributes at least half of all industrial production and a similar share of merchandise exports (see Table 1 and Table 2). In addition, many commercial activities are agriculture-based. Policies and actions that promote the development of agribusiness will therefore have significant impacts on total production and exports and on employment and national income. Agribusiness adds value by performing functions like transportation, storage, and processing that consumers desire. It has been shown that in general Government can not perform these more cheaply. If agribusiness and Pakistan are to prosper together, the attitude that the middleman is parasitic must be replaced by the notion of a businessman trying to earn a profit by adding value to the product he receives in response to the needs of the consumer. This study recommends steps the Government can take to promote agribusiness that are consistent with this change in attitude.

In the past, analyses of policies that might have an impact on agribusiness were generally studies of individual commodities. These examined the market structures of the major crops and livestock products and the policies that pertained to them. Occasionally a study focused on the "agro-industrial" area. The most comprehensive studies of the constraints to agribusiness development in Pakistan were completed under the ACSCA project.

One element of the agribusiness complex which has not been examined in detail by previous studies is the financial system. The operation of the financial system in Pakistan is crucial to agribusiness. A shortage of working capital is reported by the ACSCA and other projects to be a chronic problem among agribusinesses. Moreover, the financial system can

Table 1 Pakistan: Value of Production of Selected Agribusiness Industries, 1986-87

	Millions of Rupees	Share
All Industries	200,555	100%
Direct Agribusinesses	99,971	50%
1. Food Manufacturing	36,682	18%
2. Manufacturing of Textiles	35,538	18%
3. Tobacco Industries	11,465	6%
4. Ginning, pressing, and bailing of fiber	9,436	5%
5. Manufacturing of leather & leather products (except footwear and wearing apparel)	4,920	2%
6. Beverage Industries	1,930	1%
Indirect Agribusinesses	6,609	3%
7. Manufacturing of wearing apparel (except footwear)	2,830	1%
8. Manufacturing of footwear (except rubber or plastic)	1,272	1%
9. Manufacturing of paper and paper products	1,777	1%
10. Manufacturing of wood and cork products (except furniture)	469	0.2%
11. Manufacturing of furniture and fixture (except primary metal)	261	0.1%

Source: Economic Survey, Statistical Supplement, 1990-91, p. 74.

directly affect the relative incentives to engage in agribusiness or other economic activities.

The financial system in Pakistan is currently undergoing changes the effects of which may be as dramatic as those of the nationalization of the commercial banks in the early 1970s. The most visible change in the financial system has been the privatization of some of these same commercial banks. Pakistan has a structural adjustment loan, part of which is facilitating rationalization of the financial system.

Table 2 Pakistan: Value of Exports of Selected Agribusiness Industries, 1990-91

	Millions of Rupees	Share
Total Merchandise Exports	138,342	100%
Direct Agribusinesses	55,247	40%
1. Cotton Yarn	26,675	19%
2. Raw Cotton	9,553	7%
3. Rice	7,846	6%
4. Leather	6,184	4%
5. Fish & Fish Preparations	2,576	2%
6. Cotton Waste	1,255	1%
7. Guar & Products	653	0.5%
8. Animal Casings	309	0.2%
9. Raw Wool	196	0.1%
Indirect Agribusinesses	42,687	31%
10. Ready Made Garments and Hosiery	18,666	13%
11. Cotton Cloth	15,199	11%
12. Carpets and Rugs	4,999	4%
13. Sports Goods	3,099	2%
14. Foot Wear	724	1%

Source: Economic Survey, Statistical Supplement, 1990-91, Table 10.5.

There are several kinds of institutions that extend credit, including commercial banks, development banks, cooperative banks and societies, *modarabas*, and other investment schemes and organizations, many of which may be affected by the changes underway. Some of these institutions are being restructured, and the system is acquiring new regulations. From the point of view of finance, too, then, the time is ripe for making constructive suggestions for the shaping of the system from the point of view of agribusiness.

Because recent governments have actively intervened in the agricultural sector and their policies have had substantial impacts on agribusinesses, analysis of the constraints created by such policies will be an important part of this study. The entrance of the Government into agribusiness production also had a substantial impact on various agribusiness sectors, so it will be important to document and analyze the changes underway as government exits this area. In addition, agribusinesses have acquired a structure and role in the economy of the nation based on Pakistan's history and earlier administrative objectives. The constraints resulting from these developments will also be studied.

The availability of capital is often mentioned as a significant obstacle to agribusiness development. A key opportunity for the study is to examine whether this is likely to be the case in the changed financial sector and to make timely recommendations. Finally, tax policy creates relative incentives to invest in different sectors. Is there any bias in Pakistan's tax code, either for or against agribusiness? This factor also needs to be taken into account.

1.2 Objectives

The objectives of the study are to identify current constraints to agribusiness development and to recommend further actions needed to improve the environment for investments in this sector.

The study attempts to be comprehensive in covering both agricultural input and output sectors, as well the key financial sector. In this way it will demonstrate the scope of the issues involved and permit rational policymaking across the sectors.

1.3 Approach

This study can attempt to be comprehensive because much previous work exists. This body of policy analysis includes many commodity-based and similar studies completed in cooperation with USAID. This study will draw out the implications for agribusiness from these analyses and extend them into more recent years. A substantial amount of policy analysis and experience resulted from the policy dialogue which the Government and USAID have conducted under the Agricultural Sector Support Program (ASSP). This knowledge will also be drawn upon. Finally, the study seeks to build on the results of the ACSCA project. By including more sectors, it will make recommendations that are more comprehensive than those made under ACSCA. This study will also update the status of constraints on agribusiness to take account of changes since the ACSCA field work was completed. In particular, this will include a review and analysis of the Government's program of privatization, and its impact on the agro-industries affected.

The ACSCA project defined agribusiness activity as including the suppliers of inputs and technical know-how to farmers and the processors and distributors of farm output. Similarly, ACSCA defined an agro-industry as one comprised of a number of agribusinesses which collaborate or compete in 1) producing and supplying the same or closely-related agricultural input products to farmers or 2) transforming the output of farmers into other agro-industrial or consumer products.[1] This study will also adopt these definitions.

It is also important to note that in Pakistan there is a substantial diversity among agribusinesses in terms of their size, form of organization, degree of formalization, and ability to generate employment. Examples range from large-scale modern spinning mills and fertilizer plants to moderate-sized flour mills and vegetable ghee plants to small and largely informal seedsmen and local grain traders. Many agribusinesses are closely held by a family, but modern, corporate businesses also exist. Government policies that attempt to provide benefits to a group of consumers, producers, or agribusinesses can have impacts on any or all of these types of agribusinesses.

Agricultural producers are serviced by an agribusiness system which includes input suppliers and output marketers, processors, and exporters. Traditionally, agricultural policy assessments and analyses have focused on motivating agricultural producers. By contrast, the broader **agribusiness systems approach** to policy analysis (adopted both by ACSCA and in this study) can yield important insights into constraints and opportunities. These can be translated into assistance to governments in choosing the most productive, sustainable growth paths for these systems, which include both agriculture and agribusiness.

The agribusiness systems approach is based on the recognition that agents in commodity systems do not act solely on the basis of the conditions affecting one commodity at one market level, but rather on the basis of the conditions affecting related commodities at different levels. A properly functioning marketing system passes these interactions through from one level to the next. Thus consumer demand will drive a freely functioning market system with its preferences. This is particularly true in export markets, where Pakistan strives to earn foreign exchange.

Useful insights can also be gained from an analysis of the history of agribusiness development in Pakistan. The approach of Chapter 2 is to highlight themes that are important to the nature and structure of agribusiness in Pakistan, but not to engage in an empirical description of the agribusiness sector. The formulation of policy towards agribusiness is influenced by a number of social, economic and political factors. These have their roots in the recent history of the region, not just since independence, but also in developments during the period of British rule.

The shortage of working capital problem is examined beginning with a historical perspective. This determines how the supply of capital available for debt has been managed by the country's central bankers, how it has been distributed by the formal banking sector, and how it has been used by agribusinesses. The approach employed includes a review of the pertinent literature, with a focus on the credit issues within the agribusiness sector and on the global supply of and demand for all types of credit. This includes analysis of specific issues like

---

[1] RONCO Consulting Corporation, 1990, *Agribusiness Industry Case Study Report*, p. 11.

supervision of bank lending margins on certain commodities, subsidization of loans to farmers, investment incentives, and supervision of the banking sector as a whole.

The review of literature on credit and working capital is complemented by a series of interviews with agro-industrialists, leasing companies, investment banks, government officials, bankers, both private and public, and consultants. One cannot address the working capital problems of agribusinesses without examining the working capital situation of farmers, as farmers supply agribusinesses with their major inputs. If the farming sector is short of working capital, this will not only reduce its output, it will also put added pressure upon the agribusinesses to supply the capital.

1.4 Overview

The study begins with an examination of private agribusiness organization in Pakistan, including its history and the current constraints associated with it. The history will cover mercantilist aspects, lessons from the informal sector, and the development of family and corporate business entities. It will contrast Pakistan's experience with agribusiness development in other countries.

Next the study summarizes the impacts of past government intervention (including entrance into production) in various agro-industries. In a companion section the study examines agricultural policies as they have been implemented in Pakistan, and analyzes the impact of these on agribusinesses. The Government's interventions into various agro-industries are changing as a result of the privatization program. The significance of these changes is brought out in the following section.

The next two parts of the report contain analyses of the constraints and incentives to investment in agribusiness that result from the changing financial system and tax code. This includes the impact of bank privatization, changes in bank regulation, and the incentives in the latest investment policy. The issue of scarce working capital is highlighted.

Before proceeding to make recommendations, the study provides some successful examples of agribusiness policies from other countries.

2. PRIVATE AGRIBUSINESS ORGANIZATION: HISTORY AND CURRENT CONSTRAINTS

2.1 Introduction

This chapter summarizes the history of agribusiness development in Pakistan. Its approach is to highlight certain themes that are important in understanding the nature and structure of agribusiness in Pakistan, rather than to engage in an empirical description of the agribusiness sector. The formulation of state policy towards agribusiness is influenced by a number of social, economic and political imperatives. These factors have their roots in the recent history of the region, not just since independence but also from developments during the period of British rule.

The chapter first surveys economic changes that occurred in the Pakistan territory prior to 1947. These changes established the basis on which agricultural production, trade and credit were conducted. Not only did the colonial period witness a notable absence of agro-industrial enterprise, apart from intermediate level processes; but the business section of society failed to achieve influence on policy-making. The agrarian hierarchy continued to be politically dominant, a consequence not only of the pre-colonial political economy, but also of the economic changes during colonial rule. These changes were predicated upon the emergence of perennial canal irrigation and agricultural colonization, which involved state land distribution. This process further entrenched the position of incumbent landed lineages, and relatively weakened that of non-landed groups. The institutional forces of the civil bureaucracy and military also gained prominence, again through the methods of land utilization.

These forces have had a dramatic impact upon the post-1947 political economy of Pakistan. The institutional controls enjoyed by the bureaucracy, and the political control assumed by the military, have been expressions of these mainsprings. During the 1950s and 1960s there was certainly a concerted effort to develop industrial production, which had been neglected by the colonial regime. But the outcome was an increasing industrial concentration, as the early entrants expanded rapidly, at the cost of a broader business base. The access to subsidized finance and protected markets led also to elements of mercantilism. Apart from the emergent large industrial groups, which had begin to forge close links with the bureaucratic and military hierarchy, the mass of middle business was left out of participation in policy-making. The lack of democratic institutions and growing political authoritarianism, as symbolized by military rule, deprived this wider business community of a role in economic policy. Moreover, a large part of business activity was, in fact, left outside the legal framework. This was the "informal" or "bazaar" sector, which continued to coexist with and indeed exceed the size of the "formal" of "firm" sector.

This element of exclusion could be one reason why the smaller business section might have supported the People's Party in the elections of 1970. A major policy initiative of the Bhutto government of the 1970s was the nationalization of larger-scale enterprise, a direct blow at the industrial assets of the "big" business houses that had emerged in the previous two decades. The growth of the public sector by such means had a major impact on several agribusiness industries, as we shall see below. During the 1980s, efforts to denationalize state industrial holdings were, by and large, unsuccessful. Efforts to dramatically increase the level of private investment, and to tap the growing amounts of liquidity confined to the "black economy," were also only partially successful. However, cotton textiles did witness a spurt of investment activity after 1985. Increasing confidence returned to Pakistani business with the clearly enunciated privatization goals of the Nawaz Sharif government. The impact of these policies will certainly be felt in the next few years.

2.2 Pre-1947 Economic Changes

2.2.1 Agrarian Growth in the Indus Basin

The agricultural sector formed the predominant part of the Pakistani economy in 1947. Larger-scale industrial production was negligible. A single cotton mill existed in Faisalabad (then Lyallpur), although Punjab and Sind provinces had produced most of British India's improved cottons. During British rule, the Pakistan region had experienced significant economic growth, especially in the alluvial plains of Punjab and Sind. This growth was based on the construction of a large network of perennial canals that took off through permanent headworks from the River Indus and its tributaries, the Jhelum, Chenab, Ravi and Beas-Sutlej.[2] Indigenous demographic resources were inadequate for bringing these newly commanded but hitherto barren lands under cultivation. Hence canal construction was also accompanied by large-scale in-migration from more densely populated tracts in the region. "Agricultural colonization" became perhaps the most significant economic and social process in this region during colonial rule.

In the Punjab, nine canal colonies were developed in the Jech, Rechna and Bari Doabs. Further irrigation expansion occurred after 1947, most notably the opening up of Thal, or Sind Sagar Doab. Groundwater resources were also tapped to supplement canal irrigation, while water resources from hydro-electric dams added a further dimension to irrigated agriculture. In Sind, three large barrages opened up the lower Indus basin for canal irrigation. The major canals subdivided into branches, and further into distributaries creating an intricate network that became one of the largest irrigation systems in the world. It is on this hydraulic structure that Pakistan's agricultural viability is based. The land would otherwise revert to arid waste or semi-arid scrub, which was its state prior to the perennial irrigation schemes, with traditional agriculture being restricted to local inundation channels and animal-driven well irrigation. Barani agriculture could at best support a fraction of Pakistan's existing population.

---

[2] This section is based on the following: Ali, 1980 and 1988).

2.2.2 Developments in Agribusiness

Based on these agrarian developments, a number of factors emerged in this region that were to affect the nature and character of agribusiness in Pakistan. These forces have continued to overdetermine and interact within the agribusiness sector.

Agrarian growth created the basis and opportunity for agribusiness operations. Wheat was a major food and cash crop. It was a major export to overseas markets till around 1920 and to other parts of British India till 1947. Cotton emerged as a major cash crop, and after 1910 American cottons were being successfully disseminated. This became the primary region for American varieties in the sub-continent. A number of market towns emerged in the new agricultural zone, with a thriving trade in agricultural commodities. Private market functionaries, rather than the state, handled this trade. Village shopkeepers and itinerant traders, *katcha* and *pakka arhatiyas*, *beoparis*, commission agents and wholesale merchants all created a commercial community in the agro-market towns. Moreover, agro-processing operations, such as flour mills, cotton ginneries and oil presses, brought in other commercial functionaries. These commercial operations occurred predominantly in the "informal" or "bazaar" sector. Some firms, such as Ralli Brothers, Volkart and the British Cotton Growers Association, were involved in trading of agricultural commodities. But the local functionaries mostly remained outside the purview of corporate law and registered firm status.

A report on wheat marketing prepared in the late 1930s identified several major market functionaries for wheat, which was the largest commodity market.[3] The marketing structures for other commodities were also organized along similar lines. These were as follows: (1) Growers, landlords and cultivators who brought their own and other growers' produce to the market; (2) Village merchants, who were also involved in shopkeeping and moneylending; (3) Itinerant dealers operating in a number of villages; (4) *Katcha arhatiyas* or small commission agents, who acted on behalf of the farmer or seller; (5) *Pakka arhatiyas* who acted on behalf of buyers who could be wholesale merchants, flour mills, or exporters; (6) Mills, that bought directly; (7) Exporting firms; and (8) Cooperative commission shops or sales societies.

Private moneylending also emerged as a major form of economic transaction, to fuel the credit needs of cash-cropping agriculture. Agriculturists' debt increased, assuming such proportions that it became a major political economy issue. The expropriation of agriculturists through mortgage foreclosure and forced sale created growing fear among the British that they could lose the support of politically important landowning lineages. The state adopted interventionist legislation to counter such threats. The Punjab Alienation of Land Act of 1901 was a remarkable piece of paternalistic legislation designed to prevent the passing of land from landed to non-landed groups. Lists of castes were drawn up for each district to determine who could be eligible to purchase land.[4] Subsequently, legislation was also enacted to prevent

---

[3] See *Report on the Marketing of Wheat in the Punjab*, 1939.

[4] See Van der Dungen, 1972; and Barrier, 1966.

displacement of agriculturists through the mortgaging of land, which was the usual form of collateral for agricultural credit. State intervention in the market for land was not accompanied by similar actions in affecting or distorting the pricing and provision of agricultural inputs or controls over output and processing (though the government did fail to raise water rates over time). Paradoxically, this relationship was reversed after 1947, as the state no longer exercised controls over the land market, but intervened progressively in the input and commodity markets.

The commercial class emerging from trade, credit and agro-processing was an important ancillary to agrarian expansion. These groups were emerging through market forces and commercial interactions, rather than state-sponsored or state controlled business activities. However, this emerging commercial class was largely non-Muslim in composition. The ensuing tensions became a feature of Muslim economic nationalism in this region. The growing antagonism between Muslims and non-Muslims that led to partition at independence in 1947 did have repercussions for agribusiness in Pakistan. The migration of non-Muslims drastically reduced the role, presence and significance of business groups. Muslims did fill the vacuum thus created, but the retardative impact was long lasting. Business groups lost the politico-economic power that might have come their way after more than half a century of economic expansion.

2.2.3 The Relative Weakness of Business

Other important developments during the colonial period also served to effectively constrain the relative influence of business elements. Agricultural colonization in the Punjab provides a highly relevant illustration of the nature of these developments under colonial rule. Groups already dominant in the agrarian hierarchy gained further prominence and authority through land distribution and acquisition in the Punjab canal colonies. This entrenched social structure then displayed great continuities into the post-colonial era. Three preponderant forces had emerged by 1947. These were the military, the civil bureaucracy and the larger landowners.[5] Each had gained great vitality through agricultural colonization. Business groups were far weaker even prior to 1947, and their mass exodus at partition led to virtual emaciation. Moreover, political organizations were also threadbare, negating another channel through which business interests could have articulated their demands and helped shape state policy.[6] Thus in terms of both economic strength and political mobilization, the business sector was relatively weak at the time of independence in Pakistan.

2.3 Agribusiness and Industrial Development Since 1947

The post-1947 development of business enterprise and industrial investment in Pakistan can be said to be very heavily weighted towards the agribusiness sector. Cotton textiles are

[5] See Ali, 1987, pp. 110-32.

[6] See Ali, 1975; and Ali, 1991, pp. 29-52.

Pakistan's largest industry, and cotton spinning is its largest component.[7] The cotton spinning industry is based on local raw material supply, while raw cotton and yarn also account for a major part of Pakistan's exports. Sugar production, with over 50 mills currently in operation, is another major industry in Pakistan. Fertilizer and farm machinery on the agricultural input side are also areas of significant investment in industrial production. In output processing edible oil and ghee mills, and some of the bigger fruit processing operations, represent larger-scale production, while feed mills, flour and rice mills and cotton ginning factories comprise medium-scale agribusiness enterprise.

2.3.1 The Informal Sector

There is also a third layer, of smaller-scale production, which is predominantly in the so-called informal sector. These operations are unregistered, and they are usually labor-intensive and family based, with products supplied to local markets. The informal sector traditionally provided the agribusiness products that later experienced a transition to formal sector factory production under the organizational form of the business firm. Examples of this transition are biscuits, fruit squashes, yogurt and white sugar. The informal sector might have given up some market share in manufactured products, but it continues to be a resilient source of supply for a large range of agribusiness goods. Often this is done by counterfeiting and adulteration of branded products, and indeed this constitutes a serious threat to established products. The high cost of the latter for the great majority of consumers, in a country with a per capita income of US$ 400, also provides continued opportunities for goods that have a trade-off between price and quality. Market development is also lacking in Pakistan, with very few truly mass consumer products that have penetrated to the vast rural and lower income urban markets.

Thus we find in Pakistan's present state of development the coexistence, not always unantagonistic, between the firm and the bazaar sector. As examples, a sizeable amount, which some estimates put at around 40%, of the sugarcane crop is retained by the farm sector for *gur* production, while the country is not yet self-sufficient in white sugar.[8] Sugar production rose steadily in the 1970s and 1980s, but any further rapid expansion in sugar mill capacity might place strains on sugarcane supply. Expansion in sugarcane area might entail opportunity costs in diverting acreage from other cash crops, such as cotton and wheat. Productivity increases (Pakistan has one of the lowest sugarcane yields in the world) will require new crop hybrids or, even more difficult to achieve, reformed agricultural organization. To keep Pakistan in line with sweetener consumption in other countries, there should be a greater diversion from *gur* to white sugar production. This substitution could also represent an enlargement of the formal over the informal sector, since white sugar requires mill production. While decline in *gur* has occurred in recent years, its continued usage illustrates the incomplete coverage of formal sector production in important commodity systems. Similarly, almost 40% of wheat output is estimated

---

[7] See *Study of the Cotton Textile Industry in Pakistan*, 1979.

[8] See Lodhi, 1988, p. 76.

to be retained within the farm sector for own consumption.[9] In cotton, while spinning is dominated by mill production, the weaving stage contains a large amount of power loom production, which is small scale and informal. Counterfeiting and substitution from the informal sector extends also to the input industries. Spare parts for farm machinery, and the smaller electrical pumps and generators, are freely provided by the informal sector. More insidiously, adulteration in fertilizers and pesticides also takes place. Price imperatives and weaknesses in marketing strategies and in distribution channels allows the entry of non-firm competition.[10]

The firm sector could almost be seen as a rather thin surface layer floating on an informal sector that absorbs more labor, creates more value and yet operates outside much of the legal, fiscal and institutional framework of state-recognized business activity. This pervasiveness is as evident in distribution and trading as it is in manufacturing.[11] Even multinationals operate through channels, such as dealers, distributors, wholesalers and retailers, that are not registered formally as firms. Market town traders as well operate predominantly outside the registered firm nexus. Moreover, the road transport system, which carries the bulk of agricultural commodities, is also very largely controlled by non-registered operators.[12] As distribution channels, trading networks and functionaries and a number of services are now structured, it would be difficult to see how an all-encompassing transition can occur towards formal business activity in the foreseeable future.

What is to be the role of policy in reforming this important element of Pakistan's economic structure? The reason why the informal sector persists must be the high costs attached, firstly, to entering formal activity; and secondly, to remaining in it. The costs of access to formal sector trade and industry involve the cumbersome procedures involved in incorporating companies and obtaining official licenses, sanctions, non-objection certificates and quotas.[13] A host of regulations have to be addressed and surmounted. This might only become feasible if the compensation is loans from financial institutions or government bodies, if these are at rates concessionary enough to justify entry. Access to subsidized finance might well be the major attraction for engaging in formal activity. Similarly, the costs of remaining in formal business appear heavy and onerous: among the more direct costs are taxation in various forms, compliance with bureaucratic procedures, labor and personnel management issues, and payments for public utilities from which informal business often escapes. More indirect costs are also incurred, imposed by the weakness of legal institutions: these include instability and uncertainty in the legal system, insecurity of property rights and inefficiency of the judiciary for settling civil law disputes.

---

[9] See Ali, Lahore Business School, Case No. 14-081-87-1.

[10] For an analysis of the informal sector in Pakistan, see Qadeer, 1983, especially Chapter 5.

[11] Hussein, 1991, Ch. 10-11.

[12] *ibid*, Chapter 15.

[13] The extensive obligations recorded in de Soto, 1989, would apply equally to Pakistan.

Nevertheless, informality also involves major drawbacks. Among these are the costs of evading labor laws and taxes, rent-type transfers to corrupt officials, to politicians, and to local coercive power networks. These payments and transfers might well exceed the outgoings and costs of formal activity. They are incurred in addition to the overall social and economic costs of undermining procedures, systems and institutionalized processes that are prerequisites of the modern state. As examples, informal activity need not conform to labor codes, and will infringe minimum wage levels, child labor regulations, worker combinations and unionization, and worker safety and health. Unregistered businesses can also be less responsive towards pollution and environmental impact factors. Auditing codes can also be evaded along with proper taxation payments. The political support of such business elements is not likely to go to those kinds of politicians who wish to reform such practices. Indeed, political representatives relying on such support will favor the continuance of illegal systems. Such are the retardative factors emanating from inadequacies in adopting and enforcing good law. Sound policy formulation must pragmatically tackle these issues as an essential part of economic modernization.

2.3.2 Business Development until 1970

Coming now to the formal sector, we have already noted that Pakistan started from a virtually negligible industrial base. Even in the more obvious industry, cotton textiles, that could have emerged from local raw material supply, industrial investment had been lacking. The cotton textile industry had instead been located in western India during colonial rule, mostly in Gujrat and Maharashtra. In 1947 industry contributed only 1% of the national income, and industrial assets were worth only Rs. 580 million.[14] Business skills were also in short supply, because of the out-migration of non-Muslim commercial groups. However, immigrant Muslims soon set up businesses in Pakistan. Business communities from the western Indian coastal cities settled mostly in Karachi and continued their hereditary occupation. These were Bohras, Khojas, and Memons. Upcountry business groups, such as the Delhi Saudagrans, also resettled in Karachi and other cities. Entrepreneurs from older Punjabi towns, such as Chiniot, who had travelled to India and engaged in such trades as leather, which Hindus eschewed, also returned and recommenced business activity. The new immigrants that had settled on agricultural land vacated by non-Muslims, or had immigrated to smaller urban centers, began to operate market town trading functions. The first few years of the new state thus saw the establishment of Muslim merchant capital.

Initially these merchant groups were reluctant to enter into industrial investment. The Korean war boom, with its enhanced demand for such raw materials as jute and cotton, first created the surpluses that could be transferred to industry. Large profits were made by exporting raw materials purchased from the agricultural sector at prices kept artificially low by government price controls. The post-war imposition of import controls created incentives for investment in consumer goods industries, while an over-valued exchange rate facilitated capital

[14] See Zaman, LBS Case No. 14-080-87-1.

goods imports. The protected market enabled the new industrialists to reap profits of 50-100%, setting perhaps a tradition of expectations of quick and high returns. Large surpluses made reinvestment possible. Between 1949-50 and 1954-55, the large-scale manufacturing sector grew by 34% per year, though it slowed to 12.4% between 1954-55 and 1959-60.[15] Cotton textile production led this initial import substitution phase, and private investment also went into other agribusiness related industries, chiefly edible oils, cigarettes, fruit and vegetable processing, matches and leather and footwear. The domestic terms of trade remained against agriculture throughout the 1950s. Price controls on agricultural goods and taxes on agricultural exports kept agricultural prices low, while protection of manufactured goods kept industrial sector prices artificially high. The resulting stagnation in the agricultural sector as well as in per capita incomes, along with the high prices paid by urban consumers, led to an exhaustion of the fledgling domestic market. The industrial downturn and growing economic problems after 1955 led to the political crisis of the military coup of 1958.

The 1950s saw the emergence of business families that rapidly expanded their industrial assets. It was these business groups that formed the genesis of the growing industrial concentration and the phenomenon of the so-called "22 families" of the 1960s. These business interests acquired the knack of obtaining finance from banks and from DFIs, such as the Pakistan Industrial Finance Corporation, which was set up in 1949 and then became the Industrial Development Bank of Pakistan (IDBP) in 1961, and the Pakistan Industrial Credit and Investment Corporation (PICIC), established in 1957. As credit agencies, with little control over the funds they provided, these bodies had to be cautious about their borrowers. They tended to support the larger, established organizations which had good security and a known high rate of profits. The government sanctioning for industrial projects, along with the scarcity of subsidized capital, established a pivotal role for the civil bureaucracy, which could thereby control and modulate trends in industrial investment.

A clear nexus was being established between the rapid rise and large profits of emergent business groups, and their access to investment funds at highly reasonable rates of interest. The seeds of mercantilism can be detected here. The protectionist nature of state policy, and the monopolistic tendencies among these groups, was diverting entrepreneurial priorities away from the "competitive forces" of manufacturing efficiency, technological change, research and human resource development. Instead, the focus was on establishing congenial and mutually beneficial ties with politicians, bureaucrats and, from the late 1950s, the military leadership. The situation was conducive for men of enterprise and drive to break out of their previous humble mercantile role, and very rapidly become industrial barons. Two quite different views of this process are given as follows:

> Ruthless, shrewd, he had little education and no technical knowledge, and only a rudimentary contact with the paraphernalia of modern business. The air-conditioned office seemed as strange to him as the suggestion that business had

[15] *ibid.*

social responsibilities. He was an industrial promoter, in business to make quick and large profits, using methods that law and polite society frowned on at best. He invested and reinvested and had little concern with plant operation. Often he had spent his life in trade, turning to industry late in his career.[16]

Another writer, a senior civil servant, put his view as follows:

The entire industrial edifice built up in this country bespeaks of the failure to take heed of the social imperatives leading to corrupt practices and exploitation of the common man by a handful of privileged persons. The system produced a class of entrepreneurs which proved to be totally oblivious to the larger national interest. They were byproducts of a closed economy, protected by a wall of tariffs, tax holidays, foreign exchange allocations at cheap rates and a general lack of competition. None of them can really claim that their ability as entrepreneurs was a material factor in building up these industrial empires. It was the taxpayers' money, the high prices paid by the captive consumers and the lavish grants of foreign exchange loans at cheap rates that were responsible for their prosperity.[17]

Because of the prospects of rapid profits from certain industries, the private sector was shy to invest in others where long gestation periods, higher technology or heavy initial capital investment were required. Several such investments were out of the reach of private industrialists. A case in point is fertilizers.[18] The first fertilizer plants in Pakistan were developed in the public sector under the Pakistan Industrial Development Corporation (PIDC). Thus Lyallpur Chemicals and Fertilizers were set up in 1958, Pak-American in 1958, Pak-Arab in 1962, Pak-Saudi in 1980 and Pak-China in 1982. The private sector entered fertilizers with Exxon Chemicals (now Engro), Fauji and the joint venture Dawood Hercules. The PIDC also established industrial ventures in outlying and backward areas. These projects might not have met private investment feasibility criteria, but they were an effort to dilute regional industrial concentration.

The PIDC had on its board members of major industrial families. It also had a program of disinvestment of plants to the private sector, and again this transfer occurred very largely to these business groups. Under Zulfiqar Ali Bhutto's Peoples Party government, the PIDC was removed from under the direct control of the Ministry of Production and placed under a new intermediary organization known as the Board of Industrial Management (BIM), set up in 1972. The fertilizer component was divested from PIDC to form the National Fertilizer Corporation, and both the NFC and the PIDC became part of 10 sector-based corporations under BIM. The

[16] Papanek, 1967, p. 36.

[17] Khan, 1972, p. 179.

[18] See Hassan, LBS Case No. 14-041-87-1.

BIM in turn was abolished during the Zia regime, and the NFC was constituted as an autonomous corporation, but under government ownership and control.

The Ayub Khan regime of the 1960s is said to have been the most promising period of industrial growth in the country's history.[19] The government moved away from the strict controls over industrial investment of the 1950s. Under the Second Five Year Plan (1960-65), these controls were replaced by an "investment schedule." However, certain controls were reintroduced in the Third Plan (1965-70), owing to foreign exchange shortages. Private investment expanded, especially in the first half of the 1960s, and business groups like Dawood, Adamjee, Saigol, Amin (Crescent), Ispahani, Valika, Wazir Ali and Ghandara grew rapidly. They begun to invest in projects other than cotton textiles and consumer goods. Thus, as mentioned, Dawood went into partnership with Hercules of USA in fertilizers, the Rana family set up a tractor plant (now Millat Tractors), Wazir Alis were involved in Vanaspati ghee production, and Shahnawaz moved into fruit processing.

The so-called "monopoly houses" also established banks and insurance companies. Seven out of 17 banks in Pakistan, with 60% of total deposits, were under their control, as well as 14 out of 47 insurance companies, comprising 50% of insurance assets. Members of these business groups also sat on the boards of financial institutions. Seven leading groups were represented on the board of PICIC, with one (Adamjee) as chairman.

2.3.3 Business Development after 1970

The growing concentration had its political repercussions in the form of the nationalization of the 1970s. This process had a major impact upon agribusiness in Pakistan. The automotive industries were brought under public ownership. This included tractor production. The earlier policy was that the heavier and larger scale industry should be nationalized. The banking system was also brought under the program. The impact of this policy was a move by the large industrialists away from manufacturing and into trading. Many shifted their operations overseas, investing in businesses in Europe, the Middle East and Africa. Private sector investment in the 1970s went below the levels achieved in the previous decade (for example, Rs. 572 million in 1972-73 as opposed to Rs. 1198 in 1964-65). However, public sector investment did increase substantially under Bhutto, (Rs. 6774 million in 1974 and Rs 18,187 million in 1977, amounting to 7.9% and 12.5% of GDP respectively).[20]

A later phase of nationalization moved beyond the earlier parameters and into the intermediate goods industries. Ghee and oil mills were taken over, and brought under the Ghee Corporation of Pakistan. The nationalization program was then extended even to the smaller agribusiness operations, such as flour mills and ginning factories. This moved the nationalization process well beyond the focus on the monopoly houses. Indeed, the middle-level

---

[19] See Zaman, LBS Case No.14-088-87-1.

[20] Burki, 1980, p. 118.

entrepreneurs, situated in the smaller towns, began to be affected. These elements had apparently been sympathetic to the Peoples Party's policies against industrial concentration. Bhutto's move against them has been imputed to his growing need for the political support of large landowners, who in return wanted control over their forward linkage operations. These smaller-scale industries were denationalized under the Zia regime.

The post-1977 period saw the 11 year rule of General Zia ul Haque. Despite stated intentions the Zia administration was not able to implement any major program of public sector disinvestment. Presumably, the civil bureaucracy, and even members of the military, were against such a move as they now had a lien over a major part of Pakistan's industrial assets. Economic planning was left largely with the bureaucracy, this hold being personified by Ghulam Ishaq Khan as Finance Minister and A. G. N. Kazi as Governor of the State Bank. Entrenched labor interests also threatened industrial action to ward off privatization. The Zia government was more successful in deregulating parts of the economy, one example being fertilizer prices. Export incentives were also provided, and import policy was to some extent liberalized. The 1980s were a period of steady economic growth for Pakistan. The GDP rose at 6.7% per annum, manufacturing at around 9%, private investment at 12%, and large-scale manufacturing at almost 10%.[21] The cotton textile sector turned around after 1985 from a depressed period, and experienced steady investment growth thereafter. But the major upsurge in industrial investment that planners had expected in this period failed to take place. Real estate remained the favored form of investment, and the inflow of remittance money from overseas Pakistani workers that occurred from the mid-1970s ended up either in land purchase or increased consumption. There was no return of the erstwhile leading business groups of the 1960s into major industrial investment in the 1980s.

Some new groups gained prominence by the early 1990s. One was the Ittefaq family, whose businesses were denationalized under Zia. Their foundry operations had significant agribusiness interests, through supply of farm machinery and capital goods for sugar production. They further expanded into textile and sugar production. Mr. Nawaz Sharif, who became Prime Minister in 1990 belonged to this family. The Monnoo Group also expanded, but retained a strong focus on textiles. The Nishat Group also expanded on the strength of its textile interests; and has recently entered banking by acquiring an interest in Muslim Commercial Bank. The Chaudhries emerged in sugar and textiles. The Crescent Group was perhaps the largest, but it was less cohesive. It too was firmly based on textiles, but had diversified into sugar, jute and banking. Some older business families also entered banking, the Wazir Alis through a joint venture with American Express, and the Habibs and Saigols through the newly created private banks.

---

[21] See Bari, LBS Case No. 14-092-92-1, Exhibits.

2.4 The Structure of Business Enterprise in Pakistan

2.4.1 International Comparisons

In terms of business organization, and fitting Pakistan's business development within an international context, we find that the country seems firmly rooted in the stage of "family capitalism." Historically, family firms, and joint stock companies that remained under family control, were the business formation that guided the earlier innovating societies away from agrarian and into industrial economies. In Britain, which first experienced an industrial revolution, the family firm was the organizational form that utilized, in a laissez faire environment, the investment potential, technological innovations and marketing opportunities that propelled industrial growth. This form was well suited to Britain's cotton textile and consumer goods industries. However, in the later industrializers, we see certain adaptations in business organization. In Germany greater state direction and control replaced the laissez faire model of the British economy. Investment banks, a form unknown in Britain, intervened directly in industrial structure. Industrialization was more deliberate and more rapid. It was weighted towards the heavier and at the time, more innovative industries, such as steel, chemicals and electrical. Investment became more capital intensive and technological innovation, along with economies of scale, played an increasing role in gaining competitive advantage. State and financial controls induced a move away from competition, and towards consolidation and concentration, leading to cartels and syndicates, and eventually to mergers and monopolies.[22]

This emergence of larger business firms was taken still further in the economy of the United States. The creation of a transport and communications infrastructure, accompanied by high per capita income, enabled the rise of a large and vibrant market, fuelled by mass distribution systems. In manufacturing, new technology was enabling economies of scale through continuous flow or large batch assembly line production. Firms that could integrate mass production with mass distribution could enjoy cost advantages with which smaller or local firms found it difficult to compete. These new, large, integrated firms were a significant move away from the older family organizations that began to characterize an earlier stage of industrialization. The new firms needed managers to administer and coordinate the increasingly complex, internal flow of materials and processes. Through efficient internal administrative coordination, managerial decision-making replaced many external market mechanisms in the allocation of resources.[23] Managerial hierarchies were developed to run these large "corporations," while family control was exercised at the level of strategic decision-making and financial goals, rather than involvement with operations and strategy implementation. "Managerial capitalism" had come to replace "family capitalism," and on this basis emerged the modern business enterprise as it is known today.[24]

---

[22] See Kemp.

[23] See Chandler, 1977.

[24] See Chandler, Harvard Business School Case No. 384-081.

Significantly, a good deal of this innovation occurred in agribusiness industries. One of the early pioneers of this process was James Duke in the tobacco industry, the founder of the American Tobacco Company. Duke transformed tobacco from a commodity that passed through traditional channels of producers, processors and distributors, to a branded product where these functions were integrated within a single organization. In agricultural machinery companies like International Harvester and John Deere similarly became vertically integrated organizations. H.J. Heinz, Libby, and Campbell Soups in food processing also combined mass production technology with the organizational form of managerial hierarchies.[25]

A major factor in the rapid rise of mass production and distribution, and with it the emergence of large corporations, was the development of a transport and communications infrastructure. In the United States and Europe the extension of the railroad enabled rapid access to a growing mass market, with the possibilities of higher transport volumes. Improved port facilities led to closer integration between overland and overseas trade and transport. The emergence of a modern road system then supplemented and further transformed this infrastructure. The more rapid flow of information, starting with the wireless and still ongoing with the "information revolution," accompanied the modernization of transport. In Pakistan these facilities have remained relatively undeveloped. No significant addition has been made to the railway system developed during British rule. The road system, both in terms of major arterial inter-city links and smaller rural highways, has also remained elemental. Furthermore, telecommunications development has been seriously retarded. While countries like Sweden and the USA stand at one end of telecommunication density, with around 80 telephones per 100 population, Pakistan is close to the lower extreme, with only one per 100.[26] These connections are concentrated in the cities, so that rural telecommunications in Pakistan are little better than non-existent.. Extremely low literacy rates and negligible health facilities have also constrained social development. These are strong retardative factors in agribusiness development. Pakistan has, therefore, yet to experience the "infrastructural revolution" that is such a major precondition for the rise of corporate economies.

2.4.2 The Lack of Integration

We have identified above the various processes by which the modern business corporation emerged. These were vertically-integrated entities that benefitted from transitions in both internal management practices and the wider, external economic environment. For Pakistani agribusiness, the models from other economies are certainly present. It is a question of achieving the right kind of entrepreneurial breakthroughs, combined with institutional and physical development, to generate either the higher demand levels of an internal mass market or the export capabilities that are the business prerequisites for economic development.

---

[25] See Chandler, HBS Case No. 377-031.

[26] See Ali, forthcoming.

Cooperatives, as distinct from corporations, are another organizational structure that have become major players in agribusiness operations in the developed, as well as in several developing, countries. The size of these cooperative ventures, and their managerial orientation, rivals the scale even of large corporations. Thus, in the milk industry, cooperatives can provide forward integration from dairy farming to milk collection, and then milk processing, marketing and distribution. The original cooperative members, the dairy farmers, would thus have facilitative access to the value added parts of the commodity system. In Pakistan, we see that the milk industry has not been structured along cooperative lines. Specific "milk plant" projects have been developed as industrial investments. Many of these have, in fact, gone "sick" because of mismanagement or pricing anomalies.

Another process of agribusiness development internationally has been horizontal integration. From a large number of producers, industry structures have emerged with far fewer, and often oligopolistic, firms. This reduction in the number of competitors, and an accompanying increase in the size of the remaining firms, have resulted from several business strategies. Mergers between firms have occurred, often the end product growing cooperation or cartelization within the industry. Acquisitions are another strategy, when firms with financial resources are able to acquire competitors. Another process is lower cost production, either through technological change or more skilled managerial coordination, which can drive less efficient rivals out of the industry.

In Pakistan horizontal integration has never really occurred in the private sector. One of the constraints has been the fact that the major investment has occurred in the textile industry, which even in the industrial economies has resisted integration. Unlike the continuous flow or large batch production process industries, textiles fail to enjoy economies of scale. This affects both the vertical and horizontal integration potential of Pakistan's largest agribusiness, cotton textiles, consigning a large part of Pakistan's industrial investment to an industry structure of smaller, individual firms. These firms have not had the capabilities, managerial entrepreneurial or financial, to begin a process of intra-industry acquisitions. Similarly, the other large agro-industry, sugar production, has had virtually no horizontal integration. There are almost as many individually owned production firms as there are production units. The industry has remained fragmented, with few prospects of major changes in industry structure in the foreseeable future.

"Horizontal integration" has come to Pakistani agribusiness in one form, that of the public sector. The origin of this has been that the state was the only major investor in an industry. This is the case with fertilizers, as mentioned above. The reluctance of the private sector to enter this industry led to its dominance by the public sector, with the National Fertilizer Corporation emerging as a broad based and multi-unit producer. Among its three competitors the Fauji Fertilizers Corporation is also virtually a public sector concern, being owned by the Army Welfare Trust (with a 1991 share issue to the public). The two other companies were a transnational, Exxon, which in 1991 divested to its own management, and is now known as Engro; and Dawood Hercules, a joint venture between a US company and a local business group, from which the former has now divested. These two companies have less than a 25 percent market share.

The other route to horizontal integration with the public sector has been nationalization policies. The tractor industry is a good example. Following the nationalization of the early 1970s, around 95 percent of Pakistan's tractor market share is with the public sector Pakistan Automobile Corporation, through Millat Tractors (70 percent) and Al-Ghazi Tractors (25 percent). Three privately-owned firms take up the remaining five percent share: Fecto, Associated Agencies and Allied Tractors. Moreover, the major share of suppliers is also located in the public sector. The basic raw material, steel, is 80 percent local supply and this is monopolized by Pakistan Steel, which is government-owned. The 20 percent imported input is supplied through the private sector.[27] For component vendors and subcontractors, public sector companies again dominate supply, through Bolan Castings, Bela Engineering, Baluchistan Wheels and the Pakistan Machine Tool Factory. There are also several private suppliers, the most prominent being Agri-Autos, Allwin Engineering, KSB Castings and Ravi Autos. The privatization program of the Nawaz Sharif government will radically alter this equity structure. It is unlikely, however, that, either as a result of denationalization or further investment, a horizontally-integrated industry structure will emerge in the private sector for tractor production. The causes of fragmentation in Pakistan's private industry seem to lie deep in the entrepreneurial culture of the country.

2.4.3 The Continuance of Family Capitalism

In Pakistan, it appears that one of the structural weaknesses in business development has been the inability to make this transition towards managerial capitalism. The family ownership and control of early industrial growth, in the 1950s and 1960s, could have phased into more managerially-oriented organizations as the business houses invested in financially heavier and technologically more complex projects. Traces of this transition were visible by the late 1960s. It is a moot point whether a failure to achieve further breakthroughs was a result of the demoralizing aspects of the 1970s nationalization, or whether the personalized control is a more inherent feature of Pakistan's business culture. Generally, there has been a failure by larger-scale private business in the country to move towards reducing family involvement and handing over operations and control to management. However, till this happens business will remain in a more "elemental" phase. The generational devolution of business concerns has indeed witnessed a further fragmentation of business assets, as each successor carves out a small niche, as a virtual factory-owner, out of the business empires so rapidly accumulated by the original entrepreneurs. The passing of a patriarch has signalled, in one business group after another, the reversion in the next generation to fragmented but autonomous business holdings. The alternative could have been the retention of consolidated business structures and management hierarchies, with individual shareholders exercising representative control through boards of directors. Tax evasion and operating in the black economy might be important reasons for

[27] "Agribusiness Industry Case Study Report," 1990: Draft, Table 6.

retaining personalized control over operations. Perhaps in agribusiness the dominance of state-owned enterprises could be said to leave little room for such a transition in the private agribusiness sector. But the symptoms are structural rather than sectoral, for the persistence of family firms exists also in economic spheres other than agribusiness. As an example, the pharmaceutical industry has "corporate structures" only in the case of multinationals operating in Pakistan, while Pakistani firms are predominantly family-based and smaller-scale. It is a paradox that, organizationally, it is the public sector that most resembles modern capitalism. Operationally, of course, the divergences are fundamental. The subsidiaries of multinational companies, too, are based along managerial structures. The recent move to privatization could have achieved incomplete goals if the structural reform of the private sector does not accompany the dismantling of the public sector.

The emergence of smaller independent companies within larger and looser "groups" of companies can have financial reasons. To attract the highly favorable debt-equity ratios, of up to even 80:20 as has happened in Pakistani industrial investment, entrepreneurs are required to register new companies. Such levels of financing are not forthcoming for investment within existing companies. Thus new industrial projects, even if they are in the same business area, take the shape of distinct companies, rather than as divisions or even subsidiaries of a parent company.

This practice gives rise to the phenomenon of interlocking directorships, which equate with the diffused equity shares of different members of a business family. The creation of separate companies has several implications. It re-emphasizes the fragmentation of Pakistani industry. The lack of corporate cohesiveness makes it difficult to achieve effective business strategies that can optimize an organization's resource allocation and goals implementation. The entire process of strategic management becomes problematical, ranging from a clear delineation of a firm's mission, through strategic choice of businesses, long-term objectives and strategies, and down to annual targets and performance evaluation.

It is said that this structure suits Pakistani business, as there is less transparency, less prospect of a nationalization of the entire business, and a more flexible identification of individual shares. Moreover, there does not appear to be a tax advantage in having holding companies, since both these and subsidiaries are subject to taxation in Pakistan. Nevertheless, the plethora of business firms also serves as a convenient basis for subdivision and further fragmentation of the business structure through succession. The trend towards "family capitalism" is thereby further entrenched with each generation.

In the past three or four years, some family-owned corporations have begun moving toward professional management by injecting non-family individuals into their top management. These corporations include the Crescent Group, the Mohammad Farook Group, the Schon Group, Packages Limited, and the Laksum Group. The factors behind these shifts are not entirely clear, nor is it known whether these changes constitute the beginning of a trend in Pakistan.

2.5 Recommendations

Several recommendations can be made in the light of the arguments and developments outlined above.

2.5.1 Broader Financing of Agribusiness

One important area of reform lies in the financing of agribusiness. This area is explored in more detail in Chapter 5, but some general recommendations are given here. Given the tendency towards "mercantilism" in the past, finance for agribusiness investment should serve a broader clientele. A number of agribusiness entrepreneurs fail to gain access to funding and loans from banks, and development finance institutions. Credit criteria should be very strictly followed by lending organizations, and the tendency of the past to give politically-influenced loans should be avoided. Thereby the incidence of bad loans can also be reduced. Bringing the more genuine entrepreneurs into the loan nexus will spur business activity in this sector. The best ways to achieve these objectives are to complete the privatization of the banking sector (see Chapter 4) and for the Government to periodically monitor the pattern of investment that emerges in agribusiness. This will provide clues as to constraints faced by certain subsectors.

2.5.2 Specialized Agribusiness Finance

Banks and DFIs should also be encouraged to develop a stronger focus towards agribusiness, perhaps by developing managerial evaluation and investment processing skills in this field. Lending organizations should be more responsive not only to long-term financing, but also to meeting the vital short-term, working capital needs of agribusiness firms.

Now that there are both public and private banking institutions, the financial institutions and industry representatives should coordinate a long-term strategy for share of investment of different agribusiness industries. Thus a consensus should be reached on investment and growth in different parts of the agribusiness sector. While it might prove difficult to retain these targets too precisely, the broad definition of intra-sectoral shares will help in investment planning, business strategies and developing appropriate infrastructural inputs.

2.5.3 Role of the Public Sector and Public Investments

The role of the government must remain an area of close evaluation. The present government has clearly committed itself to privatization of the public sector (see Chapter 4), which in agribusiness is so dominant. This policy must be fully implemented, and then the subsequent role of the government be monitored. Ideally, the state should devote its resources to the rapid development of the country's infrastructure, especially in communications and transport. These would permit the growth of national and international corporations that existing systems hamper. Rural telecommunications and road networks should receive special attention. In education, agricultural research and teaching institutions should become more focussed towards private sector needs, and carry out applied research of direct benefit to business, as well as produce graduates that are relevant and qualified for meeting the needs of agribusiness operations.

2.5.4 Simplifying Investment Procedures

The government should also simplify investment procedures in agribusiness projects and create a congenial atmosphere for foreign investment. While the present administration has made a commitment to work towards these goals, the task of cutting through overblown bureaucratic procedures is not a simple one. Foreign investors can be discouraged by the persistence of such administrative obstacles as No Objection Certificates. Moreover, they can also discourage local investors, who will tend to remain in the informal sector because of the high administrative costs of entry. Positive steps are needed to revise legal and fiscal codes in order to "regularize" the informal sector.

2.5.5 Fostering the Transition from Family to Managerial Capitalism

In this chapter, a good deal of emphasis is placed on the weaknesses of private agribusiness. The term "family capitalism" has been used to identify the structure and practice of Pakistani business. The comparative analysis with other economies shows that Pakistan has been relatively backward in achieving a transition to the modern corporate economy, or "managerial capitalism." There are several advantages for businessmen in maintaining smaller, family firms. Direct control of operations can enable "black market" activities, tax evasion, and bypassing of a number of governmental regulations. These practices add to the Government's own inefficiencies, as well as its keenly-felt revenue difficulties. For Pakistani business, as well, the retardation in incorporating managerial hierarchies can have harmful long-term repercussions. Companies are subdivided and, after a while, become unviable, very much as production agriculture does through inheritance and subdivision. Private business needs to have greater transparency, and replace existing illegal practices with proper corporate ones. When accounts are transparent, investment will flow to the most efficient companies. These longer-term benefits will outweigh seemingly higher immediate profits.

It was mentioned above that in the past few years, some large locally-based corporations have begun to inject professional managers into their hierarchies, leading to better management. One step the Government and the private sector could take to improve management in Pakistan would be to study these cases and extract the relevant lessons for agribusinesses that are growing. From these cases may also come recommendations of specific steps the Government could take to foster the transition of agribusiness management in Pakistan from its family basis to professional management.

There remains the question, though, whether the Government should play a deliberate role in accelerating the transition from family to managerial capitalism. As was noted above, such a transition might lead to growth in the size and scale of business enterprises and the incorporation of managerial hierarchies to run such enlarged organizations. This emergence of corporations, or "modern business enterprises," might also result in higher degrees of wealth and industrial concentration. Such large enterprises might tend to rapidly gain market share and become part of oligopolistic structures.

The modern corporation operates most efficiently in regions with a clearly articulated "mass market." In other words, living standards will need to increase before the size of the market for most products in Pakistan is large enough to support vertically and horizontally integrated industry structures. This is one natural damper on the rapid expansion of very large corporations.

A mass market is also predicated on a better developed communications and transport infrastructure than the existing one. Since the majority of the population in Pakistan is still rural, infrastructural development would need to take place on an extended regional base. Given the size of this task, this is another natural barrier to the ascendence of very large corporate entities. This is particularly true for large agribusinesses, since they are likely to depend more critically on the quality and extent of infrastructure available than enterprises with products that are storable and less fragile.

Moreover, the supply of properly trained managers in the country is also limited. The obvious recommendation here is for a major effort to improve the educational system and expand its reach. Again, though, the existing constraint will slow the development of very large corporations.

Thus from an economic and social point of view, there is probably more to fear from the continued proliferation of family businesses that are not run professionally and pay little in taxes than from the rise of very large corporations. The latter are not likely to become dominant in the Pakistani economy any time soon. Nevertheless, the answer to the question raised above is not necessarily that the Government should **foster** the development of large corporations. The steps the Government should take are those that will promote efficiency in the production and marketing of agribusiness products and services that are desired by consumers in Pakistan. These steps include the development of human capital and physical infrastructure and the development and enforcement of grades and standards for both products and services (like accounting). Steps like these will foster the development of companies, whether family-run or not, whether large or small, that function efficiently. In the long run, families are likely to be superseded by managerial hierarchies as the management structure of agribusinesses, because families can generally not supply all the managerial talent needed by a modern company.

From the above one can also see that a transition from family capitalism would be effected not by any single policy or specific intervention, but by an entire package of coordinated policies over a wide spectrum of governmental and business activity. The coordinating force in such policy initiatives will need to be a strong government commitment and a clearly enunciated strategy.

Various historical precedents have been mentioned. These include Germany, in terms of initiatives of state and financial institutions, and the United States, in terms of strong market articulation. Industrial concentration has also been a feature of the East Asian economies. In Japan, the pre-World War II emergence of *zaibatsu* and in South Korea the post-World War II emergence of the *chaebol* are further examples of large business structures that have resulted from a clear understanding by the state of its own policy directions, and a strong commitment to these strategies.

While it has not enunciated a strategy with refinements comparable to these cases, the Government of Pakistan has given clear signals to the economy that it believes the role of the private sector includes production and marketing, and the role of the public sector to be facilitation, and not duplication, of the private sector's functions.

Specific government policies need to be worked out in light of this strategy. One issue is the financing of business. Currently, the level at which companies are required to go public is beyond 100 million rupees of paid-up capital. Expansion therefore entails a public share offering, and this qualifies the entrepreneur for bank finance up to levels of even 80:20 debt-equity ratios. The equity part is normally shared 50:50 between the entrepreneur's capital and the public share offering. Should the former be greater or smaller? If greater, more of business capital will be tied up in fewer projects. If lesser, the fear is that less risk combined with control will lead to unscrupulous acts. However, if proper transparency is maintained, and Government enforces proper auditing and accountability procedures, then distortions can be averted. Thus the role of Government is setting and enforcing standards, not in deciding the debt-equity ratio, which should be done by private bankers. Moreover, to encourage efficiency, financing of further ventures or expansion of existing capacity should receive credit and tax incentives similar to those presently enjoyed only by new projects of freshly formed firms.

Growth in the size of firms will entail management intake; this will also make irregularities more difficult. This does not relieve the Government, however, of its responsibility to enforce institutional controls to keep business legal and above board.

Public limited companies are currently required to disclose more about their accounts than private companies. If the Government induced companies to change from private to public limited status, greater transparency might ensue. In the long run, greater transparency would lead to greater efficiency because investment would be channeled to efficient companies. The tax code contains an incentive to private companies to go public: the corporate income tax rate is lower for public companies, and the most recent proposals would increase the gap. (See section 6.3.) Of course this incentive is only effective if the tax code is enforced and private companies pay their taxes. The Government could also promote a shift from private to public companies by using not the paid-up capital but the total asset value as the criterion for going public. Before this is recommended, however, it should be studied carefully.

Finally, the Government might require owners of "groups of companies" to provide consolidated accounts. This would give a truer reading of the group's paid-up capital or asset value, and would have the same benefits in increasing efficiency as were mentioned above. In developed countries, this type of regulation is also done to enforce anti-trust regulations, which are based mostly on equity concerns. If the Government also required the **merging** of the group's companies, it would bring several more companies into public limited status. Whether this would be a good idea for Pakistan at this time requires further study.

3. POLICY CONSTRAINTS TO AGRIBUSINESS DEVELOPMENT: A COMMODITY SYSTEMS APPROACH

This chapter builds on and adds to previous research on constraints to agribusiness development in Pakistan. First it summarizes those constraints identified by the ACSCA project. Then it brings to bear the experience of APAP II in Pakistan to arrive at a current set of constraints. The current constraints section (3.2) includes an update and synthesis of other research, which extracts the implications for agribusiness development.

3.1 Agribusiness Constraints Previously Identified

The Analysis of Corporate Sector Constraints in Agriculture (ACSCA) Project undertook detailed analyses of six agro-industrial sub-sectors. These included farm machinery and Implements, seed, livestock feed, fertilizers and pesticides, edible oils, and food processing. The resultant case-studies identified specific and key constraints facing agro-industry in general and these six sectors in particular. These constraints can be categorized as follows.

3.1.1 Marketing Constraints

- A lack of market research and product planning.
- Market demand data is unavailable or unreliable.
- Marketing budgets, market testing, and product demonstration activities are absent.
- Product quality is a major constraint to product differentiation and diversification.
- Fertilizer, edible oils, seed and farm machinery have been operating under an oligopolistic market structure, which has adversely effected quality and competitiveness.

3.1.2 Production and Technology Constraints

- Manufacturers are seriously constrained by infrastructural problems, including electricity, natural gas, water, telephone, and transportation services. Industrial estates meant to optimize the use of infrastructural facilities are not located near farms and other agricultural suppliers/buyers.
- With a few exceptions, manufacturers in Pakistan utilize antiquated, worn-out equipment in plants built on an ad hoc basis.
- Quality and packaging standards are not present.

- Storage facilities and practices are very poor, resulting in degraded quality of seed, livestock feed and oilseeds.

- Cyclical demand in feed and input markets exacerbate the quality problem. One result is industry overcapacity.

3.1.3 Organization, Management and Labor Constraints

- Companies are closely held family businesses, which constrains the availability of technical abilities and the flow of new ideas.

- Middle management and overall labor turnover is extremely high.

- Illiteracy is a major problem, lowering productivity, incomes and product quality. There are few, if any, training opportunities.

- Farmers and other end users have inadequate knowledge, which results in sub-optimal use of inputs, especially in farm machinery and pesticides.

- Chronic over-employment in government-run edible oil, farm machinery, and seed companies results in inefficiency and lack of profitability.

- Health and safety standards are nonexistent at edible oil and feed mills.

3.1.4 Investment and Financial Constraints

- Domestic financial asset markets are underdeveloped.

- The primary source of credit is the state-owned banking and development finance institution (DFI) system. Loan supervision is lacking and foreclosures are rare.

- Private sector manufacturers face serious constraints with regard to working capital and inventory credit.

- Virtually no institution provides specialized technical and financial feasibility studies for potential investors and financiers in agribusiness.

- A major investment constraint is the complicated tax system and exorbitant tax rates.

- Financially thin, weak firms are unable to generate internal resources for expansion, research or market development.

- Overt and implicit price controls have prevented the development of vital forward and backward market linkages in the feed and edible oil industries.

- Entrepreneurs are often very risk averse because of Pakistan's previous political instability and economic uncertainty,

3.1.5 Government Policies, Regulations and Administrative Procedures

- The overriding constraint to agro-industrial development has been the public sector domination of the key agribusiness sectors of edible oils, fertilizer, farm machinery and seed.

- An unwieldy system of import licenses, duties, sales taxes, *iqra* taxes and surcharges prevents access to critical inputs. Export bans and severe restrictions on the export of livestock, oilseeds and edible products reduce the scope of the markets for these products.

- Depressed prices lead to low yields, low income, and small farms. Farmers' low purchasing power limits the use of expensive inputs like tractors and pesticides.

- The Government maintains its monopoly position through policy and legal barriers to entry: the sanctioning process, the deletion program, and the restrictions on certain imports in the farm machinery, livestock, and pesticides sectors.

- The Government is not playing its due role in consumer protection and quality control.

- Agro-industries together suffer from the absence of a rational, integrated policy to stimulate growth and development of this vital sector of the economy. Frequent changes in the government policies and incentives erode private sector confidence, discouraging investment.

3.2 Current Agribusiness Constraints Stemming from Agricultural Commodity Policies

The effects of agricultural commodity policies on producers and consumers may be familiar to many readers. These same policies can also have very damaging effects on agribusinesses, however. These effects include the following.

- Price policies that make a commodity cheaper (whether they are domestic or trade policies) lower the production of what is an agribusiness input, so less supply is available for processing.

- Allocation of limited resources to research also results in lower production of certain commodities and less improved processing or production technology (used or sold by agribusinesses) being available.

- Depressed farm prices create a subsidy to processors, including exporters (spinning), and may lead to excessive investment in the processing of commodities with depressed prices (wheat milling, spinning), but this does not necessarily increase value added.

- Lower prices decrease the working capital requirements for buying commodity inputs.

- Price policies may have unintended effects. For example, the wheat subsidy in Pakistan causes wheat to be used as feed for poultry, an expensive meat. (By contrast, the Government believes that wheat needs to be subsidized because the poor do not have enough to eat.) In the long run this is harmful to the poultry and poultry feed industries, because they do not gain experience with more standard feed mixes, in which the rest of the world is making technological advances. Another example is the subsidy on bags used for wheat, which discourages bulk storage, a more efficient technology.

- Pan-territorial pricing (especially in conjunction with a Government distribution system) discourages normal investments in transport.

- Constant pricing through the year discourages both storage and investment in storage facilities.

- Government distribution and the corruption that often accompanies it decrease the quality of the product received for processing and discourage the establishment of quality standards.

- Government trade monopolies and other trade restrictions deprive the private sector of the chance to (develop or) maintain contacts and experience in fulfilling basic marketing services, a loss of acquired knowledge and skills.

- Policies flowing from an "exportable surplus" approach, like temporary export bans, disrupt relationships between exporters and importers, thereby depressing incomes and employment in export industries.

- Government credit programs that focus on certain subsectors result in overfinancing of these (like UHT milk) and underfinancing of others.

- Ad hoc (volatile) policies create uncertainty, which decreases agribusiness investment.

More generally, subsidies require resources that could be used to develop infrastructure (both human and physical) that would foster the growth of agribusiness. Moreover, by intervening pervasively, government becomes responsible for the success or failure of certain industries, leaving itself open to "appeals." Even today, fruit processors think that the Government should **operate** cold storage facilities on their behalf.[28]

In Pakistan, agricultural commodity-based policies have had substantial effects on the agribusinesses that provide inputs to the production of, and market and process the outputs of, these commodities. The major effects of these policies are described below.

3.2.1 Wheat

In the 1980s government policies in Pakistan depressed the price of wheat below the domestic equivalent of world prices.[29] These policies also kept the price of wheat available from the Government's warehouses constant throughout the year and in all locations. The Government's buying and selling prices did not cover its full marketing costs. The latter situation has improved recently, partly as a result of an ongoing policy dialogue with USAID. Procurement in turn has declined. In most of the years since the end of rationing in 1987, the Government has provided a subsidy on the use of bags for storing and transporting wheat.

Low prices resulted in less production than otherwise would have been forthcoming. There was probably no reduction in the wheat available for milling, however, because the difference was made up by expensive, subsidized imports. The inadequate price gap (between procurement and release prices) translated into little incentive for the private sector to store wheat. Heavy government intervention in wheat marketing has hampered the development of quality standards by industry. Thus consumers have not enjoyed the quality of wheat that might have been available, while agribusinesses lost the opportunity to provide services, provide employment and earn revenue in the marketing area. The bag subsidy discouraged bulk handling, which for some parts of the marketing chain has been shown to be feasible and more efficient.[30] Panterritorial pricing led to overinvestment in small flour mills and uneconomic location of these mills. The combined (domestic and imported) wheat subsidy was large in relation to the budget, so a substantial amount of infrastructure or other development was sacrificed in maintaining these outlays.

3.2.2 Cotton

The price of cotton was also depressed by government policies.[31] The Cotton Export Corporation's (CEC) monopoly prevented the private sector from participating in the export trade on its own account for almost fifteen years, so traders were not able to maintain their

---

[28] Horticulture export seminar, SRD June 7, 1992.

[29] See the following for a more complete review of wheat policies and their impact on consumers and producers: Ender, Wasay, and Mahmood, 1991.

[30] See Maxon, 1991, and Coulter, 1991.

[31] For a complete review of cotton policies in Pakistan, see Block, 1991.

ability to compete in the changing world market. Although the private sector can buy and export cotton on their own account, the quantity exported is still controlled by the Government.

The cheap cotton input has resulted in inefficiency in domestic processing operations (to the extent of negative value-added in some years[32]). The inefficiency sometimes takes the form of "high-tech" equipment making "low-tech" products. Cheap cotton also fostered a concentration of investment, especially in spinning. This in turn led to a very high share of export revenues coming from cotton and cotton products, with the concomitant danger of large fluctuations in government revenue when cotton is in surplus in the world market.

While twenty years ago Pakistan had a hedge market to help traders minimize the cost of meeting their commitments, there is none today. Currently the Government has projects to institute grading in cotton and to improve the quality of ginning. Until fairly recently, the country (namely the CEC) had a reputation for exporting higher-grade cotton than it had promised when this was necessary to meet its commitments. A grading system with associated price differentials and widely in use would have sent better signals to producers about what grades were in demand.

3.2.3 Sugar

Pakistan's sugar industry is one of the few in the world that does not make payments to producers of sugarcane according to the sucrose content of their cane. This leads to low yields. The Government supports cane prices at levels higher than import parity,[33] which encourages the spread of sugarcane onto land occupied by other crops. The net result is that production occurs over a shorter time but a larger area than would be the case otherwise. While an import duty protects mills, the Government has sometimes imported sugar at a loss.

The net result of these policies for agribusiness is inefficient sugar milling and reduced supplies of inputs to other agribusinesses. Sugar mills must process more cane to recover the same amount of sugar than if the cane remained in the field longer and its sucrose content increased. Apparently the longer cultivation period can be profitable for farmers, as it is the standard method of cultivation in other countries. By encouraging the spread of sugarcane to additional land, the Government is reducing the output of competing crops like wheat, cotton, and rice that are inputs to other agribusinesses.

---

[32] Asian Development Bank, Box 2.6 "The Cotton Yarn Industry in Pakistan - Success at What Cost?" pp. 162-3.

[33] See Longmire, forthcoming; and Ender, December, 1991.

3.2.4 Rice

The Government has depressed *basmati* rice prices significantly below export parity and excluded the private sector from export trade for a long time.[34] The result has been less input for agribusinesses in the processing and exporting areas. These businesses were deprived of the opportunity to maintain their international contacts and create employment and income. Recently, and in part through a policy dialogue with USAID/Pakistan, the Government opened the export of *basmati* (and all other) rice fully to the private sector. It is also winding down the activities of the REC (see section 4.9.5).

The Government also released a higher-yielding new *basmati* rice variety, which was adopted in record time. At the time when the Government still had a monopoly on exports and the new variety began to enter that trade, there was a substantial loss of market share in the key Persian Gulf markets and an unprecedented build-up of government stocks. It is not clear if this loss was due to an inherent inferior cooking quality of the new variety, adulteration of exports, or competition from other countries exporting fine rice.

3.2.5 Livestock and Dairy

In the dairy sector, it is now well known that ADBP financed too many UHT milk plants, while at the same time the Government did not allow the export of UHT milk. While export restrictions on live animals may have depressed livestock product prices modestly, crop pricing policies distorted the feed situation significantly.[35] In particular, depressed cereal prices lowered the incentive to produce (grain and) straw, a key feed ingredient.

The Government now allows the export of some UHT milk. The UHT overfinancing situation has led ADBP to downplay agribusiness lending overall, although it will make loans to smaller entities. Thus there may now be some attention to the needs of the previously neglected "low-tech" sectors, although how much would go to dairy or livestock is not clear.

3.2.6 Poultry

The poultry industry has been the beneficiary of special tax incentives (see Annex Table 2). These have no doubt contributed to the generally rapid growth in the industry.[36] On the other hand, crop policies have altered the production and imports of feed ingredients in ways not helpful to the poultry industry. Wheat price distortions and import levies on maize pushed the feed industry into using wheat as the main component of poultry feed, while import levies

---

[34] Cf. Longmire, 1991; and Ender, Wasay, and Mahmood, 1991.

[35] See Hall and Hussein, forthcoming.

[36] *ibid.*, p. 3.

on feed machinery raised costs. Thus the poultry and poultry feed industries lost the opportunity to make use of standard, maize-based information and technology.

3.2.7 Ghee

In the oilseed and ghee complex, the Government has implemented a complicated mix of policies. For some time there has been a sensible import duty on cheap imported edible oil (palm and soy oils primarily), although it was disguised as a "subsidy."[37] Domestic prices were lower than those of neighboring countries, but higher than the world price. The duty was sensible in the sense that imported palm oil was cheap and the Government of Pakistan could earn revenue without seriously affecting the ability of Pakistani consumers to obtain needed calories. On the other hand, the import tariff used to discriminate against palm oil and for soy oil, restricting the technical choices made by the edible oil industry.

Intervention in edible oil processing, where GCP failed in the solvent extraction of sunflower, and the directed credit system, under which credit was not available for sunflower because it was not an established crop, were factors that prevented the rise of a solvent extraction industry.[38] Pan-territorial pricing by GCP limited market penetration and the sphere of operations by the private sector.[39] Weak research was also a factor contributing to the lack of viable non-traditional oilseed varieties that could be produced as input for such an industry.

There are now more equal tariffs on the two oils, and as a result palm olein is being imported for use as the soft component of ghee. The Government has also instituted an auction process for imported soy oil, replacing sanctioning and thus lowering a barrier to entry. The sale of GCP units is underway (see section 4.9.2).

3.2.8 Fruits, Vegetables, and Spices

In this area, perhaps the most damage was done to the industry by the "exportable surplus" approach that was adopted by the Government. This favored satisfaction of the domestic market before permission for exports. Ad hoc bans impeded the development of stable exporter-importer relationships (particularly in the case of chilies).

A systems approach to analyzing the constraints in these markets reveals that it will often be necessary to consider an investment as going into a "new industry" rather than an existing one. That is, the mangoes, *e.g.*, that Pakistan currently produces may not be the color or size that the export market demands, or they may be available at a time when the market is

---

[37] See Goldman, Hall, and Hamid, 1991, pp. 11 ff.

[38] See in RONCO Consulting Corporation, "The Edible Oil Agro-Industry," 1990, p. I-3, III-4.

[39] *ibid.*, p. III-12.

flooded. Thus a business plan for mango export might have to start with the planting of new orchards. New marketing and credit systems might have to be developed.

Given the level of commitment required for such an investment, it is not surprising that such investments did not occur. Export infrastructure has been weak or lacking, and there were no effective systems of grading.

3.2.9 Fertilizer

Pakistan has natural gas and desires self-sufficiency in nitrogenous fertilizer. To achieve this objective, the Government has pursued an investment policy that gives to investors guarantees of low prices for natural gas as an input to the production process. Investment in nitrogenous fertilizer production is lumpy, and self-sufficiency is justified to some extent by the volatility of world supply and prices, although there is evidence that volatility has decreased in the 1980s.[40] The Government invested heavily in nitrogenous fertilizer production itself, and until 1986 subsidized farmers' purchases of urea by levying equalizing taxes and subsidies on fertilizer producers. The uncertainty created by these interventions is likely to have hampered investment and maintained a lack of competition in the industry. This is also true for the quota-based import distribution policy that affected phosphatic fertilizers, primarily DAP. Low crop prices offset some of increased demand for fertilizer from fertilizer subsidies.

Under agreements with several donors, the Government had been steadily removing the subsidies on phosphatic and potassic fertilizers. In 1992, however, it declined to take the final step in the process for DAP and other phosphatic fertilizers, which would have freed the private sector to compete in this market. The subsidy that remains prevents the private sector from importing and selling these fertilizers competitively unless the world price drops sharply in a particular year. Privatization of NFC and NFML is underway, but proceeding slowly (see section 4.9.3).

Despite the steady removal of subsidies in earlier years, the use of fertilizer per hectare was rising fairly steadily. On the other hand, yields for particular varieties, e.g. HYV wheat, are not increasing. This is already a problem for farmers and the country as a whole; it may become a problem for the fertilizer companies as well if the reputation of fertilizer is damaged.

3.2.10 Research

It is a severe challenge for any government to successfully carry out agricultural research. The activity must be carried out over a long period of time to show results, and funding often fluctuates with the programs of different administrations and circumstances. It is thus not surprising but no less unfortunate that in general there has been underinvestment in

[40] See Ahmad, Falcon, and Timmer, 1989, p. 8 ff.

agricultural research in Pakistan.[41] Recently the Government and USAID agreed on a policy reform benchmark under which several major improvements would be made to the agricultural research budget, including a higher level of funding for operating expenses. While the Government succeeded in meeting this commitment, the following year major cuts decimated the operating budget. In general, poor targeting has reduced the amount of technology and commodities available for agribusiness. This includes improved machinery and processing equipment and improved crop varieties for higher, consumer-preferred output.

3.2.11 Seed

The Punjab Seed Corporation and the Sind Seed Corporation are arms of the respective provincial departments of agriculture, and not true corporations. These agencies sold seed at subsidized prices until 1986. They still sell seed at prices at which the private sector cannot compete, because the full costs of capital and interest are not taken account of.[42] Other disincentives to the seed agribusiness include the import levies on basic and parental seed and machinery. The seed law of 1976 does not mention or support private seed companies.

The credit needs of seedsmen are large because they must generally hold their inventory from the end of one season to the beginning of the next. Financing is also difficult because their fixed capital for collateral is limited and a perishable inventory is a large part of their total assets. The Government's directed credit programs provided no assistance to seedsmen.

Very recently the Government passed a truth-in-labeling law. If enforced, this will provide some quality assurance to farmers. A proprietary rights law for breeders has not passed yet, after years of wending its way through the review process. Such a law would protect the investment in breeding made by private seed companies.

3.3 Government Responses to Agribusiness Constraints

Besides the policy changes mentioned in the foregoing sections, the Government has very recently taken several other steps to improve the climate for agribusiness investment. These include the creation of the AgriBusiness Cell in MINFAC, the privatization of numerous public sector enterprises, and various macroeconomic liberalizations. The privatization program is discussed at length in Chapter 4.

3.3.1 Creation of the AgriBusiness Cell

With the cooperation of USAID, the Government has created an AgriBusiness Cell. According to its promotional brochure the AgriBusiness Cell

---

[41] See Azam, Bloom, and Evenson, 1991.

[42] See RONCO Consulting Corporation, *The Seed Agro-Industry*, June, 1990, pp. I-1 ff.

is a professionally staffed private sector service department within the Ministry of Food, Agriculture, and Cooperatives. The purpose of the AgriBusiness Cell is to stimulate and promote increased private sector investment and participation in agribusiness activity and agro-industry development in Pakistan.

Some of the functions the AgriBusiness Cell hopes to perform include the following.

- Target and stimulate investment
- Participate in trade shows
- Co-sponsor investment and trade forums
- Disseminate information to investors
- Identify potential joint venture partners
- Refer investors to local professionals
- Assist investors with unique problems

The ABC has appropriately limited itself to facilitating roles; it is not staffed to perform policy analysis. Because the staff and the communications capabilities of the ABC are very limited, the management of the ABC knows it must choose its objectives very carefully. One major project the ABC has taken on is finding a suitable foreign investor for a solvent extraction plant that would keep farmers on contract to grow sunflowerseed. In this case the ABC can rely on a pre-feasibility study performed under the ACSCA project.

The ABC is considering fully or partially privatizing itself. One objective of this step would be to increase funding. It might also be a good way to ensure that the private sector's interests were being addressed.

3.3.2 Changes in Macroeconomic Policy

The current administration has made several major changes in macroeconomic policy. These include changes in industrial policy (see Chapter 6) and liberalization of foreign exchange regulations. As of February, 1991, any Pakistani could open a foreign exchange account in his local bank. The rupee has been under a managed float since 1982. While it has depreciated against the U.S. dollar every year since then, sometimes the float is "sticky." The Government is also in the process of reforming its trade regime through tariffication and gradual reduction of duty levels. The changes in the foreign exchange regime and in tariffs have increased the openness of the economy and are likely to make the country more competitive in international markets.

3.4 Recommendations

Based on the foregoing analyses, the following recommendations are advanced. It should be noted that in the area of standards and grading, large expenditures (i.e., comparable to existing or recent subsidies) may not be necessary to achieve benefits. What is often required is technical consultation with the concerned parties.

3.4.1 Wheat

The wheat market needs a new and clear policy statement from the Government. The wheat marketing system that evolved after the end of rationing seems to be changing again. The increased spread between the procurement and release prices has opened the way for the private sector to participate fully in wheat marketing. Indeed, the Food Departments and PASSCO have procured less in the recent two years. There is not, however, a clear understanding among the Federal Government and the Provinces regarding what the objectives and operating procedures of current wheat policy are. Thus agribusiness entrepreneurs are also in the dark, and potential investment and employment are not likely to materialize.

To be consistent with the Prime Minister's statements that the Government should not be in production or marketing, the new policy should state clearly that the Government intends to remove itself from wheat marketing, with the possible exception of holding a food security reserve. The details of that reserve and its operation have to be clear to the private sector; otherwise its participation in wheat marketing would remain limited.[43] To achieve its new status, the Government has to remove the three subsidies on wheat that currently exist: the subsidy on domestic wheat distribution, the subsidy on bags, and the subsidy on imported wheat. The first two could be eliminated easily since they are no longer large. The last could be eliminated gradually.

Of necessity there would be new or reduced roles for PASSCO and the Food Departments. Given the distrust among regions and the lower perceived quality of imported wheat that some provinces receive, this might require an agreement equivalent to the national accords on revenue and water sharing. This is not surprising given the past importance of wheat in the diet. If those making the new policy considered evidence of the declining importance of wheat in the diet, however, it might be easier to reach an agreement.[44]

The Government and the industry should make a concerted effort to set quality standards for wheat. Grades and their associated price differentials would both send more useful price signals to farmers and millers, and allow consumers to purchase the quality they desired at an appropriate price. Flour millers in Pakistan have already demonstrated that they are willing to pay more for higher-quality wheat when they know the result will be better throughput and less wear on their machinery. As the Government exits from most wheat marketing, it will be easier to set and maintain such standards.

[43] Note, e.g., the case of sugar. The private sector has been free for some years to import sugar. Because the Government has occasionally imported sugar and sold it at a loss (e.g., from the back of NLC trucks), however, few if any have done so.

[44] See Ender, Wasay, and Mahmood, 1991.

3.4.2 Cotton

In the long run, spinning would be more efficient and competitive with no subsidy on raw cotton. To get to this position, the Government should convert the quantity-based export approach to an explicit export duty with no limit on the quantity exported. In the short run, the duty would still provide protection, but it would be more transparent than the current policy, so it would be easier for the private sector to plan exports, and it would still raise needed revenue. In the long run, the duty should be reduced as direct taxation relieves the need for raising revenue through indirect taxes like export duties. With open exports, the quantity of cotton produced and spun will adjust to each other and to world market signals. There will be less investment in spinning than otherwise, resulting in some of the industrial diversification that the country sorely needs. To ensure that the export market functions smoothly, the Government should also study the possibility of reinstituting a hedge market in cotton to see if one could be consistent with Islamic principles.

3.4.3 Sugar

This is not the first report to recommend sugarcane pricing based on sucrose content.[45] Unfortunately the suggestions of previous reports have not been implemented, so it remains an important task. Another recommendation that needs to be repeated is to strengthen research on sugarcane and sugar processing.[46] In general, the Government should reconsider supporting the price of sugarcane above the parity price when the crop uses so much scarce water.

3.4.4 Rice

When the Government released the new *basmati* variety, B-385, it had a virtual monopoly on the export trade. Since that time, there has been a significant loss of international market share. It is not clear if this was due to the inherent cooking quality of the new rice, to adulteration of exports, or to competition from India, Thailand, and elsewhere. To resolve this issue, the Government should commission a study. It should look carefully at consumer preferences in the Gulf and other major importing areas and analyze the competitive position of Pakistan's *basmati* rice.

3.4.5 Livestock and Feed

Much of the impact the Government has on these industries comes from the effects, some unintended, of crop pricing and other policies. The negative effects of these policies could be mitigated by moving toward parity pricing of major crops.[47] The Government also has an

---

[45] See Government of Pakistan, Agricultural Prices Commission, 1984.

[46] See Lodhi, 1988, p. 117.

[47] See, especially their recommendations, Hall and Hussein, forthcoming.

impact, however, by not promulgating and enforcing quality standards for feed. A well-enforced labeling law would improve the quality of feed by giving livestock producers better information on the contents of the feed they buy and stimulating competition among feed millers to produce better products. The Agribusiness Cell might work with donors to arrange training in feed analysis in anticipation of feed analysis laboratories being set up.

3.4.6 Poultry

The Government should assist the poultry industry, but not by giving it special tax breaks. The current tax incentives should not be renewed; they distort resource allocation and could be used to hide income. What the Government should do is to rationalize its crop prices (especially wheat) so that the poultry feed industry has an incentive to use maize as the primary ingredient. This would allow both the poultry and poultry feed industries to make use of modern technology and information. The Government should also do its best to provide high-quality health and other information, and where possible services, to the industry. The AgriBusiness Cell might also be able to assist with information on the possibility of exporting poultry products, particularly to the Gulf.

3.4.7 Ghee

In the ghee industry, the most important steps the Government can take are to complete the privatization it has begun (see section 4.10.4) and to promote quality standards (see section 4.10.3). Recent changes in pricing and trade policies have left the Government in the comfortable position of raising revenue with duties that do not seriously distort the incentives facing either consumers or ghee manufacturers.

3.4.8 Fruits, Vegetables, and Spices

These commodities are most affected by the Government's ad hoc trade policies. To remedy the negative effects of these, the Government should implement with respect to these commodities the policy reform benchmark to which it previously agreed. That agreement stated in part that

> The Government [would] with the exception of those commodities on the negative (sensitive) list, eliminate all export bans, quantitative restrictions, and export duties...; the Government [would] specify the commodities on the negative (sensitive) list by the start of each fiscal year (July 1) and [would] not add commodities to the list during the fiscal year.[48]

[48] These commodities and others were covered in benchmark number 8 in 1990 under the Sector Grant component of USAID's Agricultural Sector Support Program.

The idea behind the negative list is to make trade policy more consistent and more open. Thus over time the negative list should be reduced in length. The Government is already following elements of such a policy for many non-agricultural traded items.

3.4.9 Fertilizer

The near-term challenge for the Government in the fertilizer area is to get itself out of the business of production and marketing. This includes completing the privatization of NFC and NFML (see section 4.10.4) and ending subsidies and import distribution quotas. A small non-subsidized strategic reserve may be useful to cushion the effect of unusually high international prices or the unavailability of a particular grade, or to serve isolated markets not served by two or more private sector firms.

The Government should also work with the private sector to improve fertilizer use efficiency and encourage the private sector to convey more information on the use of their products at the point of sale. To support proper use of fertilizer, the Government should improve its soil testing facilities.

3.4.10 Research

This study has not made an exhaustive review of agricultural research needs. Nevertheless, it is clear that research is a key element of a public sector program that facilitates both increased agricultural productivity and the development of agribusiness. Some areas that urgently need research attention include fertilizer use efficiency, wheat varieties that can be successfully planted late (after cotton), non-traditional oilseeds, and combined harvesters that can chop straw finely and deliver it in bags.

3.4.11 Seed

Farmers are generally willing to pay prices commensurate with the quality of seed, so there is no longer any reason to subsidize the sale of seed. The Punjab and Sind Seed Corporations should thus be phased out, but they can not be privatized directly because they are not actually corporations. The respective provincial governments should thus first convert them to corporations and then sell them. The Federal Government should focus its attention on passing a proprietary rights law for breeders, which would protect the investment in breeding made by private seed companies.

3.4.12 AgriBusiness Cell

If the AgriBusiness Cell is going to play a role in facilitating the development of agribusiness over the coming years, it needs to be institutionally established and strengthened. An effective way of interacting across ministries needs to built into the ABC's charter. The current staffing model, in which the chairman is a high-level Government official and the staff are not, may be a good one to continue. The level of staffing is inadequate, however, to even the most limited set of tasks. It would seem that a director, four or five professionals to cover different industry areas, and two or three support staff are the minimum number that could produce visible results on a national level. Partial funding from the private sector may be one way to achieve this objective. Mustering support may be dependent on having some initial success(es), e.g., in the oilseed processing area (see section 4.10.3).

4. CHANGING PUBLIC AGRIBUSINESS ORGANIZATION: THE IMPACT OF PRIVATIZATION ON AGRIBUSINESS

4.1 Introduction/Overview

Pakistan's current program of privatization may have a significant impact on the conduct of agribusiness in the country. In order to assess this potential impact, this chapter reviews the overall objectives of privatization and those pursued in Pakistan, the results of the privatization program, and analyzes the likely outcome for the agribusiness sector.

4.2 Definitions

Privatization has been defined "at the broadest level...[as]...the introduction of market forces into an economy." More specifically it might cover the "transfer of commercially-oriented SOEs, activities or productive assets of the government to total, majority, or minority private ownership or to private control."[49] A financial consultant working in this area in Pakistan distinguishes between divestiture, which is movement of ownership and usually of control, and privatization, which is movement of control.[50]

When it says that the privatization program is part of "unleashing" market forces, the Government of Pakistan seems to mean that managers and potential managers in the private sector should not be hamstrung by government intervention. As was seen above, direct Government intervention into various agribusiness sectors has been a major constraint to agribusiness development in Pakistan. Partly for this reason, in this report privatization means transfer of public assets to private control. Such transfer includes both the removal of the impediment of Government intervention and also the conveyance to the private sector of control, without which management cannot respond to market forces.

4.3 Objectives

The objectives of privatization are potentially many. The most commonly cited ones are efficiency, reduction in the budget deficit, and wider ownership of productive assets. Variations on these main objectives can be seen as incentives for a government to privatize. Thus privatization may result in lower public foreign debt, lower dependence on aid, or better access to commercial credit.[51]

---

[49] Vuylsteke, 1988, p. 1.

[50] Moizeau, Privatization Advisor, (ADB), Privatization Wing, Ministry of Finance, personal communication.

[51] See for example, Gokal, 1989. Gokal also argues that the "main point of privatization is not the change of ownership but the transfer of management control. Government must be willing to share power. The government must also establish a favorable environment."

The objective of efficiency has been elegantly encouraged by a senior World Bank official:

> Perhaps the process of import substitution has reached its limits and there is need for a greater integration of the economies of developing countries in the international system of trade....The issue is not just exports for foreign exchange;...[but] will the producers be exposed to competition and the pressure it brings or will they continue to demand protection, which ultimately will perpetuate stagnation.[52]

The efficiency issue can have structural dimensions. For example, "to the extent that the informal sector is competitive and the formal sector, protected, the greatest immediate benefit might be from increasing competition in the formal sector."[53] The Government may also see the informal sector as a potential source of revenue. Reform of the regulatory system in conjunction with privatization may bring informal activities, driven out by overregulation, back into the formal economy, where they can be taxed.[54]

Privatization can have an impact on the budget in at least two ways: first, the sale of assets can bring in revenue directly; second, the annual losses of the SOEs that had to covered from budgetary resources can be arrested. If the option was to continue these losses for many years, this benefit can be quite substantial. Another possibility is that a more profitable private sector will pay more taxes than the former parastatals.

Broader ownership of assets is an objective that is generally grounded in political considerations. Improving the distribution of assets in the private sector at the time of sale of public assets is likely to be a powerful way to generate public support for privatization by defusing the claim that public assets are going to insiders connected to the current government. Successful diffusion of ownership may also be a good way to increase investment.

Moizeau summarizes these objectives, saying that the "only objective" is the delivery of goods and services that the population desires in a more efficient, effective and equitable manner.[55] While this is undoubtedly the long-run goal, other "non-objectives" like raising money for the government, increasing the private sector role, spreading ownership of assets, strengthening capital markets, and attracting foreign investment may also be very important for particular countries and governments at certain times.

---

[52] Husain, 1989.

[53] Development Research and Management Services, 1991, p. 8.

[54] Bienen and Waterbury, 198 p. 619.

[55] Moizeau, unublished mimeo, 1990.

4.4 Lessons from Other Countries

This chapter does not attempt to provide a complete analysis of Pakistan's experience with privatization. Thus in this section lengthy comparisons to the experiences of other countries are not warranted. Nevertheless, some examples of the lessons learned in some of those countries may be of interest in considering the process underway in Pakistan and its likely impact.

In Eastern Europe, Kornai describes the social dimension of privatization as "the creation of a business or middle class," whereas the economic objectives include giving stronger incentives to work and to encourage better management. There is too much attention, he feels, to how to privatize state assets, and not enough to the concept of creating a new class, and a new business climate.[56]

Chile had a difficult history with a number of bankruptcies and economic reversals due to the 1981-3 recession. There Nankani finds that "it is possible to undertake a sweeping privatization program through: Setting up an adequate institutional framework to oversee privatization, establishing special incentives for small investors and workers, and passing legislation specifically aimed at guiding the participation of large domestic and foreign investors and pension funds. She cautions, however, that privatization on an extensive scale is best avoided; ownership concentration can and should be avoided; the critical role of organizing and implementing worker participation should not be underestimated; and if privatization is to occur in a period when the Government is undertaking significant stabilization and liberalization programs, even more emphasis needs to be placed on adopting the right policy sequence, that is, deregulation, stabilization, liberalization, and privatization.[57] With regard to privatization of agribusinesses in developing countries, "deregulation" is likely to include "reregulation," in that a proper role of government includes actions like providing grades and standards and in general is to ensure a fair "playing field."

Nankani's World Bank report also reports on progress or the lack of it in some other countries, including Sri Lanka. There she finds that not much has been achieved. A variety of techniques were used for privatization, including complete and partial transfer of ownership, joint ventures, and management contracts. Management contracts, the least problematic of the divestiture instruments, were used extensively. Despite the commitment of the Government, many obstacles were encountered, including the intense political nature of privatization due to vested interests on all sides; the hostility of previous governments to the private sector and the private sector's own tendency toward secrecy; the need for legal reorganization; the lack of attention to sectoral policy analysis, in spite of a long "readying" phase; and the absence of a clear focus on specific institutional arrangements aimed at encouraging participation by the private sector.

---

[56] Kornai, 1991, pp. 32-40.

[57] Helen Nankani, World Bank Technical Paper no. 89.

In New Zealand, Jones finds that full privatization was more successful than partial privatization. Private sector minority shareholders were in a good position to "capture" management, whereas partial ownership also made it difficult to change the regulatory environment due to conflicting public and private interests. In addition, open bids for purchase of an enterprise were found to be superior to share market sales. The large size of sales meant it was necessary to allow foreign bidding to ensure maximum value for the taxpayer.[58]

Some of these lessons have special relevance for Pakistan. It has already been mentioned, in section 4.3, that partial privatization, normally through the sale of only a minority of shares, is not likely to have much impact on the performance of the enterprise. The importance of fostering a managerial class is taken up in Chapter 2 of this report but is also useful to bear in mind here when considering the potential impact of privatization on the operation of agribusiness. There is also the related need for business to become more open and accountable. Only when there is more information available about the operation of private sector businesses can the public choose properly which ones to invest in and the Government monitor whether there is competition or collusion. The latter is critical when, as in Pakistan, the shift is from agribusiness subsectors dominated by the Government's enterprises to the hoped-for benefits of private sector competition.

The capacity to do sectoral policy analysis and the sequencing of policy reforms are also mentioned in relation to other countries. These may be key lessons for Pakistan, as good analyses in the agribusiness sector have been very few, and little progress had been made in changing the regulatory framework before the privatization program began.

4.5 A Brief Background to Privatization in Pakistan

4.5.1 Institutions

Pakistan's first experience with privatization seems to have been in the 1950s. At that time

> the Pakistan Industrial Development Corporation (PIDC) was set up to speed up the process of industrialisation. PIDC embarked upon a number of industrial projects. It ran these projects on an economically viable scale, established a satisfactory record of profitability, and handed them over to private entrepreneurs. This was popularly known as the disinvestment scheme of PIDC.[59]

Clearly this kind of privatization differs from that under discussion in this study in that the goal of the program from the outset was to establish private enterprises. Today's privatization

[58] Jones, 1991.

[59] Tallha, 1991.

program is engaged in returning to the private sector businesses taken from it with no intention of their return. The government of Z. A. Bhutto carried out this large-scale nationalization in the 1970s to counter the social effects of an apparent concentration of wealth. For further discussion of both PIDC and some details of this nationalization, see Chapter 2.

The Government's efforts at privatization began with the establishment of the National Disinvestment Authority (NDA) in 1985. The Government gave permission to the private sector to establish banks in 1986, although letters of intent were not handed over until 1991. The environment for privatization was enhanced by the Governments of Zia and Junejo (March, 1985- April, 1988), in that neither established any new public enterprise.[60] Following on this path, the new manifesto of the Pakistan People's Party (PPP) under Benazir Bhutto made a firm commitment against nationalization. Under Bhutto ten percent of PIA's shares were sold by the Corporate Law Authority to the public in May, 1990. The minimum investment was Rs. 1000, and a minimum dividend of 12.5 percent per annum was guaranteed by the Government for 3 years.

The response to the PIA "privatization" was strong; this helped to demonstrate that there was capital in Pakistan looking for places to invest. It was also a good exercise in preparing the public for true divestitures. Because of the limited scope of the sale, it was not itself privatization, but rather a fund-raising scheme. Technically, the exercise was "not well done:" the earnings estimate was reduced from Rs. 1.1 billion to Rs. 400 million right after the sale, so if owners want to sell their shares, their value may be a lot less after the three years of guaranteed return.[61]

The National Disinvestment Authority was made a separate agency in June, 1988, with a full staff of about 45. The PPP government abolished the NDA and replaced it with the Privatization Wing of the Ministry of Finance. The Wing has a full staff of about 15, including 2 professionals and one advisor. The Wing had no implementing authority, being a staff agency only.[62]

The current Privatization Commission was established by the IJI[63] government on January 22, 1991. It reports directly to the Cabinet Committee on Privatization, which is chaired by the Finance Minister. It has fifteen members, including its Chairman and Secretary, of whom nearly all are either ministers or secretaries of concerned ministries or former heads of government corporations or agencies. The only apparent private sector members are an

---

[60] Mullick, 1990.

[61] Moizeau, Privatization Advisor, (ADB), Privatization Wing, Ministry of Finance, November 8, 1990, personal communication.

[62] *ibid*.

[63] Urdu acronym for the Islamic Democratic Alliance.

advocate and a chartered accountant.[64] According to a recent newspaper article, the Chairman, Senator Qadir, "could not readily accept the proposal to include representatives of the various chambers of commerce and industry on the privatization commission."[65]

4.5.2 Laws

Technically the Government of Pakistan does not need to pass a law to carry out privatization. A law in this context is more of a policy statement that prepares the way and reaffirms the principle of private ownership of property. The history of nationalization and denationalization laws thus sheds light on the relations between the various actors in privatization, in particular the Government, the previous and current managements, and current employees.

Zulfiqar Ali Bhutto nationalized industries in the 1970s with no compensation. In 1978 the Government passed a law that said if there was denationalization, then the original owners would get the first chance to buy back their assets. An August, 1988 ordinance[66] said that anyone could bid, but this was never made into law, so the previous law remained in force.[67]

When disinvestment began in earnest in the 1990s, there were complaints that there was no legal cover for what the Government was doing, more specifically that there was no discussion in the Parliament. Disinvestment, it was said, was "being done through amending the Denationalisation Ordinance piece by piece as the need arises."[68] One example of this method was in the ghee industry. To facilitate privatization there, the Government added a new clause to the previous law.[69]

Eventually the Government responded with an ordinance giving broader cover to the process, called the Protection of Economic Reforms Ordinance of 1991. The debate on its utility has not changed. Some maintain that "the ordinance does not provide adequate protection to the reforms, as the law can be amended with a simple majority in Parliament, which every future government, wanting to reverse them, will obviously enjoy." Proponents of this theory feel that constitutional protection is essential. On the other hand, Secretary General (Finance) Saeed

---

[64] "Privatization Policy and Its Implementation," Ministry of Finance, Government of Pakistan, January, 1992, p. 1 and Annex I.

[65] "Qadir to give performance report to Parliament," Dawn Economic and Business Review, March 1, 1992.

[66] An ordinance is a temporary law promulgated by the President without the approval of Parliament; it needs to be ratified by Parliament to become law or extended by the President; otherwise it terminates automatically after 6 months.

[67] Charles Moizeau, Privatization Advisor, (ADB), Privatization Wing, Ministry of Finance, November 8, 1990, personal communication.

[68] *Dawn Economic and Business Review*, February 23 - March 1, 1991 "Privatization without parliament's consent."

[69] "Vegetable Oil Industry Ord promulgated."*The News*, April 28, 1991.

Qureshi stated logically that "the real security for the continuity of these reforms will be their success. No government could secure its economic policies by providing them a constitutional cover."[70]

One further change in the laws contains the rights given to employees of the enterprises being privatized. The National Assembly passed a bill to further amend the Transfer of Managed Establishment Order of 1978. It gives the employees the right to purchase a unit if they offer the highest bid.[71]

4.5.3 Recent Performance of SOEs

The financial health of SOEs has often been a matter of some controversy. Before serious privatization began, it was not uncommon to see newspaper reports of significant profits being made by these corporations. Now the tide has turned and the reports show significant losses.

One outside review done before the process took off showed that, indeed, "the public enterprise sector as a whole is not self-sufficient and is a significant contributor to the government's resource gap." The study described the overall situation as follows:

> Some [SOEs] have been established for non-commercial objectives,... but the goals of most [SOEs] are formulated with a commercial surplus in mind. [In almost all LDCs,] public sector enterprises contribute to the resource gap, and Pakistan is no exception. [For the 167 SOEs studied,] the gap between savings and investment declined to Rs. 8.6 billion from Rs. 10.1 billion from 1980 to 1985, but there was a substantial need for investment that was not filled in many [SOE] sectors, including the post office, manufacturing, transportation, finance, energy, and trade. Even if taxes and dividends paid to the government are included in the resources generated [by the SOEs], the gap is only reduced to about Rs. 4.5 billion.[72]

Other recent reports echo this theme. One claimed that the equity base of units of PIDC and the State Engineering Corporation had reached the final fringes of complete erosion, that these corporations each had accumulated losses of nearly one billion rupees.[73] Another study

---

[70] "Insecure businessmen demand constitutional cover." *The News*, August 13, 1991.

[71] "Employees given right to purchase nationalised units," *The News*, March 5, 1992.

[72] LaPorte and Ahmed, 1989, pp. 66ff.

[73] Based on a performance report of 75 state-owned units by the Government's Expert Advisory Cell for the year 1988-89. "State-owned industries" (Editorial), *Business Recorder*, 1990.

estimated that in 1987 "the combined assets of all public sector companies had a net return of 0.14%."[74]

Similar reports described individual sectors. For example,

> The Government pumped a tremendous amount of funds into the banks as capital to keep them going. The figure as given in the National Assembly on June 26, 1990 was Rs. 13.6 billion and far more of the public money is expected to go that way....All the five public sector banks together yielded a profit of only Rs. 6.16 million this year, and the income estimates for next year are no better. The performance report of the Ministry of Finance for 1989 showed that the loan recovery of the MCB during 1989 was only 50 percent, while that of the Allied Bank was 32 percent.[75]

For government agribusinesses, the results were alike. Returns on assets in 1988/89 were estimated at 2.3% for GCP and 7.4% for NFC.[76]

4.6 The Objectives of Privatization in Pakistan

The Government has stated the broad objectives of privatization and deregulation as:

- Creating a liberal economic environment
- Removing trade and tariff barriers
- Improving national productivity
- Achieving rapid industrialization
- Facilitating access of the private sector to financial resources
- Improving efficiency and profitability
- Insulating the economy from political interference
- Developing a viable capital market
- Releasing resources for social and physical infrastructure.[77]

While efficiency, productivity, and profitability are clearly key objectives, reducing the drain on government resources so they can be available for "social and physical infrastructure" is also critical. According to *The Economist*, "Sartaj Aziz, the finance minister, says he wants to 'cut his losses of $1 billion every year.' Servicing the debt takes up nearly 30% of government

---

[74] "Running to market," *The Economist*, March 30, 1991.

[75] "Bankers' protest," *Muslim*, July 1, 1990.

[76] Church, 1990, Table 1.

[77] "Privatization Policy and Its Implementation," Ministry of Finance, Government of Pakistan, January, 1992, p. 1.

spending."[78] A recent World Bank report opined that the "poor state of the overall transportation system results in part from the cumulative effects of inadequate past maintenance and upgrading."

4.7 Constraints to the Implementation of Privatization in Pakistan

Constraints on privatization can be classed into at least two major categories. There are those constraints that prevent implementation of the policy, and those that limit the success of the policy after implementation.

A significant factor restraining the government of Benazir Bhutto was opposition from labor groups affiliated to her party. Some 300,000 people work in state-owned enterprises, which have often been a convenient vehicle for patronage.[79] The Government's eventual solution to this problem was to guarantee the employees a certain period of employment after privatization. This of course was not desirable from the point of view of the potential new management.

In addition the bureaucracy is said to not against privatization and, even more so, against the transfer of management to the private sector.[80] Indeed, one prominent observer feels that "patronage suits the Government bureaucracy and vested interests including management; labor is not the major problem in getting rid of government corporations."[81]

The entrenchment of the public sector enterprises is partly due to the privileges they enjoy, including subsidies, guaranteed access to credit, and policies and regulations which affect the market for public sector goods and services. The subsidies include grants, reimbursement for operating costs, and subsidized inputs. Favorable policies and regulations often include fixed prices and may create a scarcity of goods they produce, which in turn guarantees the enterprises a market. Import duties often have the same effect.[82]

From the private sector's point of view, there were "several underlying reasons and factors which have been proving as a damper on the private sector's potential to step up its role. The development of infrastructure facilities, a responsibility of the Government, is trailing far behind the demand from the sponsors of the sanctioned and prospective industrial projects. Frequent changes in the Government's economic and industrial policies" were also an important

---

[78] "Running to market," *The Economist*, March 30, 1991.

[79] *ibid.*

[80] Ahmed, 1990.

[81] Haq, 1990.

[82] LaPorte and Ahmed, 1989, pp. 106ff.

problem.[83] Other constraints from management's perspective were the "inflated" reserve price or the law-and-order situation in some areas.[84] A more sanguine view of Pakistan's big businessmen is that they "have always played a riskless game. [They] thrive on policy favors and take risk only with bank money."[85]

Frequent changes in policy are only one component of what one might term "instability." These factors affect investment in general, so they also affect those who might buy a public sector enterprise. Investors consider the long-run value of their investment, although their horizons may differ. Over the long run, Pakistan has experienced swings of government from rightist to leftist and from military to civilian, nationalization of many industries and the commercial banks, and the breaking off of Bangladesh. This history conditions the expectations of both foreign and domestic investors. Thus the Government's challenge is to convince investors that the changes underway will be long-lasting. One response was the legal cover mentioned above (section 4.5.2).

The main factors limiting the success of privatization as it is implemented occur in the economic environment. These are subject to modification both by public policies and by private actions. Thus one observer believes that privatization "can be a success only if the Corporate Law Authority checks the abuses of monopoly companies and the Karachi Stock Exchange plays a cleaner role, instead of being a party to insider trading and other abuses. Clearly the ethical standards of the private sector will have to go up substantially."[86] The key point here is that a change of management that does not result in increased competition in an industry may not result in improved goods and services for consumers. This will be discussed further in section 4.9.

4.8 Techniques of Privatization in Pakistan

In the current program of privatization, the main methods being used are:

- Sale of individual state-owned enterprises by inviting bids from the private sector
- Encouraging employees to constitute Employees Management Group and negotiating with them a market price of share on the basis of an evaluation of assets, liabilities and net worth, besides promoting the concept of ESOP (employee stock ownership plan)

---

[83] "Incentives for investment," *Business Recorder*, October 26, 1989.

[84] Bokhari, 1991.

[85] Kazmi, 1991.

[86] Ahmed, 1990.

- Entering into a lease management contract with employees for a specified period to enable them to buy out units.[87]

In the case of banks being privatized, the first method may also include sales of shares to the public that are underwritten by the successful bidder.[88] In the case of Muslim Commercial Bank, the successful bidder (the new management) bought 26 percent of the shares, and the public were to be offered 25 percent. In general, the Government sells all of its equity, which varies, reserving 10 percent for sale to the employees.

The sale of Allied Bank Limited is the first example of a buy-out by an employees' management group. One measure of the enthusiasm for privatization in this case is that the employees were reported to be "prepared to sell their wives' ornaments to purchase their shares."[89] The Allied privatization is also the first example of an ESOP. At the time of privatization, the Government planned to sell 14 percent of the total shares through the stock market, leaving a decision on the sale of remaining (35%) shares for some time in the next two years. The shares sold to employees are nontransferable for five years.[90]

Another method of privatization that has been discussed at various times is offering shares to the public. The Sui Northern Gas Pipelines Limited was to offer its shares in July, 1992 to public subscription "and a direct private placement with a foreign technical collaborator."[91]

In the course of privatization, two key issues that have had to be dealt with are compensation for employees made surplus and the transparency of the sale process.

4.8.1 The Agreement with Employees

The employees of the SOEs being privatized have a significant stake in the outcome of the program. Many stand to lose their jobs if the new management finds some employees surplus and chooses not to employ them in additional branches or positions. The Government

---

[87] "Privatization Policy and Its Implementation," Ministry of Finance, Government of Pakistan, January, 1992, pp. 5-6.

[88] Bank privatization is supervised by the State Bank of Pakistan, while industrial units are the responsibility of the Privatization Commission.

[89] *The News*, August 5, 1991.

[90] "Allied Bank Limited is the first example of a management-workers' buyout deal," *The News*, August 6, 1991.

[91] "SPNGL subscription from 27th," *The News*, July 16, 1992.

has come to a fairly generous agreement with the workers (shown in Table 3), right to purchase up to 10 percent of the shares of the unit.[92] There have been few of the disruptions that once had been threatened.[93]

Table 3 Details of the Accord between the Government of Pakistan and the All Pakistan State Enterprises Workers' Action Committee (APSEWAC)

1	No layoffs during the first twelve months.
2	Ten percent of the shares of the privatized units to be offered to the employees.
3	Employees surplus after the initial period of 12 months to be given priority for employment abroad and provided easy credit for facilitating their self-employment.
4	Until such time as these employees are placed in employment, they would be entitled to unemployment benefit at the rate of Rs. 1,000 per month for a maximum period of two years.
5	Training to be provided to surplus workers.
6	Grants to be made for the marriages of their daughters, and scholarship to be provided for the education of their children. Employees opting for the golden handshake to enjoy one month's gratuity for each complete year of service and four months' last drawn basic salary for each year of service.
7	Employees will have the opportunity to purchase any unit.
8	Employees will receive concessions through negotiations if they are the successful bidders.
9	Employees will submit a management plan with any bid.

4.8.2 Transparency

The transparency of the sale process is an important issue because the Government wishes to maintain public support for the privatization process. If the process is not seen to be reasonably fair, the public may turn against the Government.[94] More concretely, in order to obtain the substantial capital required to privatize the large number of enterprises listed, the Government will have to attract the general public. These individuals will need to be assured

[92] The agreement is "generous" in the sense that it clearly includes benefits that would not accrue to employees under normal circumstances. On the other hand, no analysis has been made public by the Government of the prospective costs of this agreement in relation to the revenue expected from the sale of SOEs and the savings likely to accrue by virtue of reduced losses.

[93] Workers of all the non-financial SOEs went on strike for at least three days in June, 1991 against the privatization policy of the government. "PM takes notice of resistance to privatization," *The News*, June 12, 1991.

[94] The IJI is a coalition, not a single party, so it is susceptible to fragmentation and even loss of its majority if an issue proves sufficiently divisive.

that the process of privatization is fair, that they will therefore get reasonable value for their investment.

There have been various complaints levied on the privatization process. In fairness it should be said that the privatization envisaged in Pakistan is quite ambitious, and has certainly not been undertaken in Pakistan before. The proposed privatization in Pakistan may be the largest and most extensive in the Third World.

Issues surrounding the reserve price have attracted much criticism. This is not surprising, in that the valuation of the assets for sale is one of the most important parts of the entire process. One of the complaints is that valuation was done by independent private sector firms and they may have provided the evaluation reports to the prospective bidders.[95] In the case of the Muslim Commercial Bank, it is claimed that "the Government rejected the highest offer, fudged the auction rules, then accepted a revised offer from the third-highest bidder. Rivals got a stay order from the courts, though after a backroom deal in mid-March the Government got its way."[96]

In addition to verbal responses to inquiries, the Government saw fit to provide a detailed explanation of the evaluation process in the cases of MCB and ABL in its recent publication on privatization, even though financial institutions were not included in any of that reports' compilations of progress.[97] Recently the Chairman of the Privatization Commission said that he "would recommend that the Government accept the [private sector's] proposals to: 1) Declare the reserve price at the time of inviting bids, 2) Make the draft agreement available at the time of issuing the letter of intent, and 3) Allow joint audit evaluation."[98] If the Government accepts this recommendation, the transparency, and thus the momentum, of the privatization process should improve.

4.9 The Sectoral Achievements of Privatization in Pakistan

Perhaps the most important achievement of the Government's privatization program is that it was planned to begin with the privatization of the banks. Reform of credit policy has also begun at about the same time. Previously, credit was directed and was not given on the basis of projected profitability. The public sector had differential access to financial resources. Without sound, independent private banks, investment in the private sector will remain seriously constrained. For more on changes in the credit system and their impact, see Chapter 5.

---

[95] "Qadir admits WB disapproval," *The News*, October 15, 1991.

[96] "Running to market," *The Economist*, March 30, 1991.

[97] "Privatization Policy and Its Implementation," Ministry of Finance, Government of Pakistan, January, 1992, pp 9-10.

[98] "Qadir to give performance report to Parliament," *Dawn Economic and Business Review*, March 1, 1992.

4.9.1 The Financial Sector

Muslim Commercial Bank was the first major privatization by the Government. With the somewhat troublesome process of going private apparently behind it, the bank seems to be reacting to its new status in appropriate ways. According to one report, the

> "bank's deposits soared by almost four billion [rupees] since the bank was denationalized by the government four months ago. New management has added several features to attract new customers (including rapid loan approval, and foreign credit cards, and slashed the number of tiers of management). ...The new management found the bank had 3,500 surplus employees out of a total of 13,000. It however decided to redeploy them in new branches...and even new businesses.[99]

More specifically, the banks' new credit policy, dated September 1, 1991, calls for "improving the Bank's portfolio, ...more efficient service, and bring[ing the] Bank at par ...with the standard of international banks." It requires the staff to evolve a marketing strategy, including identifying and encouraging good clients, something they probably never would have had to do under the previous system. The new policy gives details of careful credit investigations, pointing out that the particulars of charges (liens) are often difficult to ascertain. The policy rules out lending for speculative purposes (which is illegal), but it also prescribes the conditions under which lending by hypothecation of stocks is acceptable, and how to monitor such lending. Regrettably for professionals, including accountants and other consultants, lending to such individuals and companies is not allowed. Under monitoring of lending, the new policy recommends personal visits to solve any problems that are detected, eschewing correspondence. These and other elements of the new credit policy show that MCB is taking the proactive, careful, and profit-based approach to banking that one hopes for in a private bank.

The second and other NCB to be privatized so far is Allied Bank Limited. The 7,500 employees of ABL succeeded in amassing Rs. 490 million to take control of the institution. Allied Bank was established in 1942; it has 747 branches in the country and three overseas.[100] Allied Bank president Khalid Latif has been quoted as saying that "there was no surplus staff."[101]

Unfortunately, Allied has also had its share of trouble stemming from the privatization and its aftermath. A court case is underway. A senior official of the banks says that obtaining employees' signatures on blank transfer deeds of share certificates was legitimate because "at the time of payment of 26 percent share price, about 2,000 lower cadre employees did not pay

---

[99] "Rs. 4 Bn increase in MCB deposits," *The News*, August 8, 1991.

[100] "Allied employees fulfill ownership requirement," *The News*, August 31, 1991.

[101] "Govt to encourage buyout of enterprises: Qadir," *The News*, September 24, 1991.

in full...and their contribution was paid by others.... Employees say the management is trying to obtain the signatures on blank transfer deeds from all employees, including those who paid in full.[102] Clearly this case has implications for the success of "employee" buy-outs.

The impact on agribusinesses of privatization of NCBs should be positive in the long run. No impact can be reported at this time, however, particularly since the credit policy of the Government is still in flux. Over time one would expect sound and independent private banks to lend more to profitable private enterprises than the NCBs did, and to diversify their portfolios more. This would contribute to needed diversification of the industrial structure in Pakistan. (As Table 1 shows, textiles and food manufacturing activities like flour milling account for a major share of agribusiness and significant shares of all industry.)

4.9.2 The Ghee Industry

The privatization program in the ghee industry has come a long way. Not long ago the Government had proposed selling GCP shares to the nationalized commercial banks. This would have had the effect of not showing additional debt and not making GCP liable for interest, while at the same time the likelihood of GCP's paying any dividend was very small. Subsequently the Government agreed in its policy dialogue with USAID/Pakistan to study the feasibility of disinvesting part or all of GCP. The new (current) Government quickly decided to proceed with the disinvestment of GCP as part of its overall privatization program.

As of January, 1992, letters of acceptance had been issued for 7 ghee units, and offers had been received for matching 90 percent of the reserve price for 2 additional units, out of a total of 24 in GCP.[103] By July, 1992, management had been transferred at 6 units, and 4 more had made payments and should eventually be privatized. The Government remains committed to selling all the units of GCP.[104]

Some complaints have been encountered in the privatization of the ghee industry as well. Fazal Ghee Mills, it is claimed, was "handed over to old associates after dropping conditions of bank guarantee.[105] However the Government's status report as of July, 1992 shows a bank guarantee of Rs. 60 million given for Fazal Vegetable Ghee. More serious from an economic point of view is the claim by the same group that the purchasers of ghee units were mostly interested in the value of their real estate, although if the units in question were not profitable, then their closure is a reasonable outcome of privatization.

---

[102] "Allied Bank controversy deepens," *The News*, March 1, 1992.

[103] "Privatization Policy and Its Implementation," Ministry of Finance, Government of Pakistan, January, 1992, pp. 19-20.

[104] Masihuddin, Secretary, Privatization Commission, personal communication, July 21, 1992.

[105] Privatization Investment Promotion Group, 1992.

The sale of GCP units to the private sector is likely to reinforce a trend toward efficient and competitive functioning in the industry that stems from other recent changes in policy. If some units go out of production after transfer to the private sector, presumably this will be because they were not profitable, and the net result will be to relieve some of the overcapacity in the industry. As recently as 1989, an ACSCA study concluded that the GCP, which once produced "about 90 percent" the country's ghee,[106]

> produced about 37 percent of the country's ...vegetable ghee.... At the 30 percent level, the target established by the Government, the GOP share of the market would still be strong enough to generally set the upper level of prices....[107]

At the time of the ACSCA report, only sanctioned mills received an allocation of soy oil, which was imported only by the Government. This was a barrier to entry into the industry, because standard technology in Pakistan utilized palm oil in combination with either soy or cottonseed oil. Beginning in September, 1990, soy oil was sold at auction to both mills and oil traders. After the suspension of imports under P.L. 480, the importation of soy oil was opened to the private sector in December, 1990.[108]

4.9.3 The Fertilizer Industry

As of January, 1992, five units of the National Fertilizer Company, including NFML, had been offered for sale, but no letters of acceptance had been issued.[109] Recently it was announced that the Schon group had purchased 90 percent of the shares of the Pak-China fertilizer factory, at a cost of Rs. 450 million, in an auction of the Privatization Commission.[110] Other units are in various states of offering or refurbishing. NFC's largest unit, Pak-Saudi, was offered for sale but became the focus of a tussle between competing groups. The Government is currently trying to sell it to a foreign investor to be located by a foreign bank with experience privatizing fertilizer units. The Government would also like to sell the Pak-Arab unit, but must first satisfy its joint venture partner, the Abu Dhabi National Oil Company. The Pak-American unit is likely to require modernization before it can be sold. Nevertheless, the Government is committed to selling all of NFC.

---

[106] Ronco Consulting Corporation, *The Edible Oil Agro-Industry*, November, 1990, p. IV-11.

[107] *ibid.*, p. I-2.

[108] "TCP to begin soyabean oil auction on 9th," September 3, 1990 and "ECC policy favours soyabean oil lobby," *Business Recorder*, December 11, 1990.

[109] "Privatization Policy and Its Implementation," Ministry of Finance, Government of Pakistan, January, 1992, pp. 16, 18-19.

[110] "Fertilizer factory goes to private sector," *The News*, June 16, 1992.

Of the approximately 1.2 million nutrient tons design capacity of existing fertilizer plants in Pakistan, less than 300,000 tons were in the private sector before privatization began, namely with Engro (formerly Exxon) and Dawood Hercules. Pak-China adds less than 50,000 tons, but Pak-Saudi would shift over 250,000 tons. Given the apparent economies of scale in urea production, investment in fertilizer plants is likely to remain lumpy and thus somewhat concentrated. Nevertheless, if farmers, and ultimately consumers, are to get the full benefits of privatization of this industry, the Government must make a concerted effort to bring more competition to the industry. In crops like wheat, farmers are applying more fertilizer than before and getting yields that are no higher. Although this problem does not stem entirely from the amounts and ways fertilizer is used, competition among fertilizer suppliers might induce them to include extension services in their product. This might in turn bring better information to the farmer and raise his productivity.

4.9.4 The Tractor Industry

The Government of Pakistan, through the Privatization Commission, has transferred management of Millat Tractors, Al-Ghazi Tractors and Baluchistan Wheels (which makes all of the tractor wheels made in Pakistan) to the private sector. Millat was sold to its employees. Al-Ghazi went to a company from the United Arab Emirates.

Before privatization the structure of the tractor industry was described as

> dominated by the GOP ownership, management, or control of the factors of production, including the manufacturing enterprises, raw material and component suppliers, and credit institutions that finance the industry. Eighty percent of the raw materials, component parts and subassemblies for locally made tractors are provided by five state-owned and operated heavy industry, casting, machining, and manufacturing companies. The GOP, its holding companies and financial institutions own 70 percent of the largest tractor company and 51 percent of its sole competitor. The two companies together manufacture 95 percent of all tractors sold annually in Pakistan. In addition 80 percent of all tractor sales are financed by the GOP's agricultural development bank.[111]

With the sale of both tractor companies and Baluchistan Wheels there has apparently been a total shift of assets from the public to the private sector. However, the Government retains ownership of Pakistan Steel, Bolan Castings, Pakistan Machine Tool Factory, and Bela Engineers.[112] These companies manufacture steel; manufacture engine blocks, transmission cases, axles, and differentials; manufacture transmission gears and shafts; and assemble engines,

---

[111] Ronco Consulting Corporation, "The Farm Machinery and Implements Agro-Industry," April, 1990, p. I-4.

[112] Bela Engineering and Bolan Casting have also been advertised for privatization (*International News*, March 27, 1992 and July 26, 1992).

respectively for one or both of the tractor companies. In the past the price structures of the products and services of these companies have been "uneconomic," and the companies have sustained losses and low rates of return on capital.[113]

The newly private tractor companies might show profits in the coming years if the Government's pricing policies for the upstream products do not change. On the other hand, the ACSCA report also describes the technologies and machine tools used in the industry as "technically obsolete, in a poor state of repair," and unlikely to produce at a level required for even tractor replacement purposes.[114] Thus it seems that the impact of privatization on the tractor industry is mostly to change the ownership of the companies. In the short run the companies may make profits, as a result of the Government's policies. In the long run, however, if the Government is to cut its losses, it must revise its pricing policies for the materials and assemblies that go into tractors. The private sector will also have to take decisive action to upgrade the plants they are operating.

4.9.5 The Rice Export Corporation

REC is being phased out. Of its 8 mills in the Punjab, management has been transferred in two and four others have made the required payments and provided bank guarantees.[115] Mills in the Sindh have law-and-order problems. REC still has a major rice cleaning facility in Karachi. In complementary fashion, procurement has been deliberately decreased substantially so the private sector can enter the trade. *Basmati* rice exports have been suffering from among other problems price competition between the public and private sectors. Clearly this would no longer be a problem if REC is closed down.

Rice export policies were liberalized over the past three years, particularly in the wake of very weak sales of *basmati*. The private sector should be in a better position to assess the problems of exporting, whether they are simply strong competition from India, Thailand and to some extent the United States, or if there are any quality problems with the latest variety. If there is a quality problem that is inherent in the variety, as opposed to adulteration somewhere in the marketing chain, the Government will need to work effectively with the private sector and farmers to test and approve other varieties.

4.9.6 Other Agribusinesses

At various times there has been mention of privatizing the Cotton Export Corporation and PASSCO. At this time, the Privatization Commission is quite intensely occupied with the numerous industrial enterprises it is attempting to transfer to the private sector. Thus there are

---

[113] Ronco Consulting Corporation, *The Farm Machinery and Implements Agro-Industry*, April, 1990, p. I-4.

[114] *ibid.*, p. I-5.

[115] As of July 14, 1992.

currently no concrete plans to privatize CEC or PASSCO. Cotton trade has been partly private since 1987, but it is still controlled by the Government through the benchmark price and the time of entry of the CEC into the domestic market. In the case of domestic wheat storage for food security, it would be more logical to retain a small national organization and phase out the provincial food departments, but this is politically impossible now.

4.10 The Overall Impact of Privatization on Agribusiness in Pakistan

One recent assessment of progress in privatization was

> Within a period of one year, in first attempt, out of 25, commission failed to receive bids for 11 units and only single bids were received for 9. In the second attempt, out of remaining 100, bids were received for 81 and no bids were received for 19 units. Only a few of these units have actually been transferred that also mostly real estate plots of Roti and Ghee units. Progress has only been made on 4 or 5 real industries and in all these cases serious disputes have arisen.[116]

As of July 14, 1992, 35 units had been turned over to private management and about 15 more were in the pipeline.[117] It is not meaningful, however, to assess the impact of privatization simply by counting the units privatized. As the following section shows, to realize the full benefits of privatization, transfer of management must be accompanied by changes in regulation. The pace of privatization, however, may be affected by these very regulations.

On July 1, 1992, banks in Pakistan became subject to a new prudential regulation that prevents them from giving guarantees equaling more than 30 percent of their unimpaired equity. Since a bank guarantee to the Government for any outstanding payments is a requirement in the financing of privatization, this has the effect of slowing down the process. Banks are now demanding that buyers of state enterprises deposit with them 100 percent of the amount to be guaranteed. It would be simplistic in this situation to judge the success of privatization by its pace alone. The progress made on the policy side of the banking system is also of key importance: there must be financially solid banks to finance both privatization and industrial development in general.[118]

---

[116] Privatization Investment Promotion Group, 1992.

[117] Four, including one ghee mill, were sold back to the original owners, and three, including Millat Tractors, to employee groups.

[118] A recent lesson along these lines involves a new private bank that had given out guarantees equaling 300 percent of its paid-up capital, and its demand deposits were not being honored. SBP had to suspend its operations and put it under audit.

4.10.1 A Framework for Analyzing the Impact of Privatization on Public and Private Sector Roles

Privatization is a program that attempts to alter the roles of the private sector and the government. Thus to analyze the actual or potential impact of privatization, one needs to examine the key aspects of these roles and their interactions. The following definitions will be useful to an analysis of public and private sector roles.

Planning: Analysis done in anticipation of the production of (agribusiness) goods or the provision of services to or by (agri)businesses.

Control: The power to determine (agribusiness product) prices, total and/or regional market shares, and/or production.

Regulation: Establishment and enforcement by the government of standards for (agribusiness) products and rules for business practices.

Coordination: Systematic decisionmaking leading to consistency of policies toward (agri)businesses and/or to efficiency of operation of (agri)businesses.

These actions are of course related. Planning, as it is defined here, is often a prerequisite to coordination. An example in the public sector would be in the provision of infrastructure. Regulations may be among the consistent policies that flow from coordination.

In a simplified fashion, one can examine the distribution of these actions in the three main modern economic systems. This is particularly relevant to Pakistan, where in the last three decades the economic system has changed substantially from a fairly free-wheeling, laissez-faire system to one in which the Government owned and controlled a large part of the economy, and again to a more mixed system. The system may now be going through another period of significant change.

The roles of the public and private sectors in the three economic systems are shown in Table 4. Notice also that prices are another spectrum on which the systems could be arrayed. In the laissez-faire system, prices are very important, but there is little or no government intervention to achieve price stabilization. At the other end of the spectrum, central planning has no prices at all. Somewhere in the middle, the mixed system incorporates some price stabilization; some price variability is acceptable.

Finally, one can look at the systems from the point of view of satisfying consumers, namely providing high-quality goods and services efficiently. In the totally free market system, it was not uncommon for there to be collusion and other abuses. These eventually led to various forms of regulation of workplace and product safety and of pricing and other business practices. At the other end, the centrally planned system has a very difficult time satisfying consumer demands because it does not get feedback from consumers through a pricing system, nor does

Table 4 Roles of Public and Private Sectors in Main Economic Systems

Function/System	Laissez-Faire	Mixed	Centrally Planned
Planning	Private sector	Private, public sectors each plan own products	Public sector
Control	Diffused in markets, may become concentrated	Diffused to moderately centralized	Public sector
Regulation	Minimal	Moderate to substantial	Variable
Coordination	Private sector	Private, public sectors each coordinate own activities	Public sector (difficult to achieve)

it have an incentive-based system of management.

4.10.2 Government and Private Sector Roles in Pakistan

The Government of Pakistan has always engaged in planning. The ACSCA studies have shown that the Government has also employed much control, but not much regulation or coordination. As a result, the private sector has not been able to coordinate its activities sufficiently nor have consumers received the benefits of adequate regulation. In recent years Pakistan has been a mixed economy, tilted toward central planning.

While control and planning are necessary in all economies, the locus and concentration of these is one key question for Pakistan today. Will the Government give up control of banking and various agribusiness industries? Will it, on the other hand, provide the regulation and standards that are necessary for the effective and equitable functioning of the economy? If the Government had consistent policies and development plans, the private sector could depend on certain public goods and services, and its strategies would be more effective. Will the reforms hold?

One form of planning in the private sector that is particularly absent in agribusiness in Pakistan today is sales planning, or "marketing." Will the current reforms lead to better marketing and business strategies?

4.10.3 The Impact of Privatization on Government and Private Sector Roles

The **AgriBusiness Cell** is an example of the Government's trying to coordinate rather than control. While ABC is not a product of the privatization program, its role is becoming even more important as privatization proceeds. Government control is apparently decreasing, and the private sector is emerging from a period of domination by the public sector. The need is strong for an agency that can effectively facilitate the removal of obstacles and the provision of needed services by the Government. If the Government undertakes more of these kinds of efforts in conjunction with privatization, agribusiness development will accelerate.

The ABC may now be planning to privatize itself. Support for the ABC, regardless of whether it is public or private, constitutes an appropriate shift in the role of the public sector. Private funding of the ABC would also be appropriate.

In the **banking** sector, the Government is giving up control gradually. While some banking institutions have been completely privatized, the Government retains substantial direct, allocative power in the evolving credit program. On the other hand, the Government has done a very good job of increasing needed banking regulation. In the private sector, sales planning shows signs of emerging in the privatized banks, and private sector managers now have the power to coordinate within their own enterprises. The system is moving in the right direction. It will not see the full returns to the reforms, however, until the shift away from directed credit is complete. Thus agribusiness will also not receive the full benefits of the privatization of banking—credit allocated according to risks and rewards—until credit reform is concluded.

Because of the pervasive impact of the banking system in the economy, it is not appropriate for the Government to change the system hastily. It has undoubtedly not taken lightly its decision to "discontinue the existing system of credit ceiling for individual banks." The likelihood is that the reform of the credit program will continue. The remaining question is its pace.

In the **ghee** industry there has not yet been enough privatization to say that control is out of government hands, but other factors, including policy changes, have already led to substantial competition. The Government has yielded some control by going to auctioned soy oil, although import tariffs remain a potent weapon in its arsenal. One of the major thrusts of the ABC is to facilitate further investment in oilseed processing. This effort is seen as a way to relax a major constraint in the system, namely that there is no reliable market for non-traditional oilseeds like sunflower. This coordinating role could be crucial in inducing both farmers and the industry to produce and process significant amounts of non-traditional oilseeds.

In the area of regulation, there are at least two important issues for the ghee industry and its supporting subsectors. The first is the legal basis for commercial seed production. The Government has been slow in approving a complete seed act, a key piece of enabling legislation. The other issue concerns the quality and safety of ghee. Many bogus claims have appeared in the press about certain products being inedible because they melt at higher than body temperature, or for other spurious reasons. Nevertheless, the quality of the ghee consumed in Pakistan is an issue, just as the quality of other consumer products is important. While consumer product regulation may not be a high priority for the Government at this time of very scarce resources, the attention given by the Government to regulatory issues is an indicator of its position *vis-a-vis* the role of the public sector.

In the **fertilizer** sector, also, privatization is proceeding at a limited pace. While the Government's plan is to disinvest as completely as possible, for the moment it retains control. A related policy is the subsidy on imported fertilizer, primarily DAP. There, delayed removal of the subsidy may be evidence of unwillingness to give up control or only of political weakness.

The fertilizer sector is different from most others. The necessity of large investments (in urea production) has led to a small number of firms and limited competition in a given geographical area. As the Government relinquishes control, it has some potential to increase competition. However, it may be that the largest benefit to the society of privatization is the recovery of the invested capital, which could then be invested in other areas like education or infrastructure.

Tractors and related enterprises are another major sector undergoing privatization. The Government has sold both tractor companies and Baluchistan Wheels, and offered Bolan Castings and Bela Engineers for sale. Even after the transfer of the latter, however, the Government would retain a substantial measure of control via pricing policy at Pakistan Steel. On the other hand, after such a sale, the private sector would have enough power to coordinate among and within the newly privatized enterprises to make substantial improvements in productivity.

In the case of the **REC**, the Government seems prepared to give up control of rice exporting. What is a critical issue for *basmati* rice is important for other grains like wheat and IRRI rice: grading and standards are sorely lacking. In August, 1990, the Government agreed to a policy reform benchmark to establish such standards, but there has been no real progress. Consumers, processors, exporters, and farmers could all benefit from this positive kind of regulation.

4.10.4 The Impact of Privatization on Competition and Efficiency

The degree of competition in an industry is affected by industry structure, the effectiveness of regulations aimed at business practices, and various economic policies. That is, there will tend to be stronger competition when there are more firms, when anti-trust laws are enforced, and in the absence of distortionary policies, e.g. licensing, that may create rents for certain firms and/or barriers to entry.

The enterprises being privatized by the Government can be viewed in two different ways. On the one hand, the total number is small with respect to the number of firms in the economy. On the other hand, the enterprises are concentrated in a small number of sectors. Because of this concentration, there is potential for privatization to have a substantial impact on competition by increasing the number of competing firms in an industry.

The agribusiness industries where competition is most likely to improve after privatization are ghee and rice exports. If the Government completely disinvests its ghee holdings, there should be little to prevent competition among ghee producers. Similarly, if the Government does in fact wind up the REC, the private sector should be able to take over the export trade and compete among themselves. In both sectors progress will not be optimal until constructive regulations and/or standards are established, but the effects of competition should be clearly seen. Even in the absence of regulation, one would expect a continuation of the incipient trend in the ghee industry to establish brand names in conjunction with quality or other differences in products. Quality standards would provide a valuable floor in this process.

The impact of privatization on competition would also be enhanced if enforcement of anti-trust laws were strengthened. Apparently a set of such laws are on the books. Strong enforcement does not seem likely, however. Despite an increase in staff, the approach of the chairman of the CLA is apparently to be more tolerant during the period of privatization.[119]

Even in the total absence of public sector enterprises, the private sector will not be a magic cure for the problems of the agribusiness sector. The private sector in many cases has to learn its way around. The effects of competition will not be felt immediately. This is another reason for the Government to maintain its resolve.

In the past, feed millers removed labels from their products because their products did not conform to what was on the label. This is an inappropriate response in a mature economy because competition will defeat it; educated customers will demand labels. At the time, the market did not yet have a sufficient level of competition to make removing labels an ineffective strategy. The next time a firm tries labeling, it may succeed by persevering and improving quality at the same time. Again, there is no enforcement of laws like truth-in-labeling.

That quality has value is demonstrated by the PASSCO experiments selling cleaned wheat to millers. When the millers knew that the quality was improved, they were willing to pay more for the wheat. This experience has been repeated in many other countries. What this example shows is that Pakistan is not so different that the lessons of other economies about issues like quality are not relevant.

There is some evidence that competition has not been the normal mode in Pakistani agribusiness subsectors. One hears that the flour millers and the spinners have at times openly

---

[119] Abdullah, Chairman, Corporate Law Authority, personal communication, May 5, 1992.

fixed, or tried to fix, buying and selling prices. On the other hand, the evidence is not clear whether the millers really have exercised substantial market power, and the Government was able to jawbone the spinners' trade association out of setting a buying price and strategy for its members. On balance it appears that in a few, large, well-established industries, like these, there is a tendency to act as a group first and as competitors second. On the other hand, it seems likely that, with a set of policies that created an equitable environment for competition, the private sector would generally respond competitively.

So far, with the possible exception of banking, privatization has not proceeded far enough in any sector to have a substantial effect on competition. In the banking sector, competition is probably already on the increase, but it is too early to see any concrete results. The synergy stemming from the privatization of banking and also of a specific industry will generally lead to the most competition. Of the major agribusiness sectors being privatized, the ghee industry is most likely to reap these benefits. If disinvestment is substantial, the remaining obstacles to competition among the industry participants would be few.

As in all the sectors, part of what will sustain competition is the Government's approach. Its resolve to attack problems before they arise by thorough planning and after they arise through proper regulation will result in more efficient production in agribusiness. It will also lead to greater confidence among the agribusiness community in the stability of the Government's policies, which in turn should lead to more private investment. Conversely, by taking control, the Government would make the problem its own and probably make the solution more difficult.

5. THE CHANGING FINANCIAL SYSTEM: IMPACT ON AGRIBUSINESS

5.1 Introduction

Credit is an important input in any modern economy. Its effectiveness can be enhanced or limited by any number of related factors. However, credit alone can rarely lead developments in an economy. The allocation of credit in a stable and predictable, yet competitive, environment is carried out by bankers of the formal banking sector. These bankers are free to assess risk and price their funds accordingly. Motivated by profit, they can direct credit where it is most effective. Where competition is healthy, they will find ways to mitigate risk, enabling them to venture into areas of the economy that would otherwise be ignored. However, in an environment where the playing field is not level or distorted by non-market forces or government intervention, the performance of these bankers will be adversely affected. As a result, banking institutions would not efficiently fulfill their roles as financial intermediaries.

The future availability of capital (debt or equity) will have an important role in determining the rate of growth of the agribusiness sector. The question of availability of capital to agribusinesses was initially raised in a series of sectoral studies carried out under the Analysis of Corporate Sector Constraints in Agriculture Project (ACSCA) in the latter part of the 1980s. Specifically, a number of agro-industrialists indicated that the growth of their businesses was being constrained by a lack of working capital. Thus, it was evident that the issue of availability of credit, working capital in particular, needed to be examined before any recommendations could be made regarding the promotion of agribusiness development. This has become even more important in light of the GOP's recent efforts to privatize, deregulate, and expand the financial sector.

In this chapter, the shortage of working capital problem is examined. The chapter begins with a historical perspective to determine how the supply of capital available for debt has been managed by the country's central bankers, how it has been distributed by the formal banking sector, and how it has been used by agribusinesses. The approach employed includes a review of the pertinent literature, with a focus on the credit issues within the agribusiness sector and on the global supply of and demand for all types of credit. This includes analysis of specific issues like supervision of bank lending margins on certain commodities, subsidization of loans to farmers, investment incentives, and supervision of the banking sector as a whole.

The literature review is complemented by a series of interviews with agro-industrialists, leasing companies, investment banks, government officials, bankers, both private and public, and consultants.[120] In these interviews, agribusinesses are differentiated from agricultural producers (farmers). One cannot address the working capital problems of agribusinesses,

[120] The list of persons interviewed is found in Annex 1.

however, without examining the working capital situation of farmers, as farmers supply agribusinesses with their major inputs. If the farming sector is short of working capital, this will not only reduce its output, it will also put added pressure upon the agribusinesses to supply the capital.

The chapter begins with an in-depth, practical description of working capital. It then gives a general description of Pakistan's credit supply and delivery system for agribusinesses. Under the heading "Credit Issues," the major problems are summarized and discussed. The recommendations given in the last section are meant to be incorporated into a more global commodity systems approach, rather than acted upon individually.

5.2 Working Capital

The shortage of working capital issue is one that has been the cause of many heated banker-client discussions wherever there are bankers and clients. This section provides a discussion of working capital: how it is made available, its sources, and how it is used, both in theory and in practice.

5.2.1 Working Capital Defined

Working capital is what a business uses to finance its daily operations. The most frequent uses are to obtain inputs (raw materials, supplies), carry out the production process (labor, repair and maintenance) and temporarily finance accounts receivables (sales on credit). Thus working capital is different from capital which would be used to purchase a fixed asset like a tractor or land, or to construct a building, etc.

Working capital can be classified as permanent, temporary and "locked-in." Permanent working capital is the amount of money that is "tied up" in permanent inventory levels in the form of either raw materials, work-in-progress, finished inventory or accounts receivable. This amount is usually identified at the start-up phase of a project. (See Figure 1.)

Temporary working capital, on the other hand, is for a more specific use and is required for a shorter period of time. It is usually required to finance an abnormal fluctuation in the production cycle. Examples would include a special order of product, a seasonal production schedule, and the seasonal availability of an input that is required year-round. (See Figure 2.)

"Locked-in" working capital is a term that some bankers use to describe the portion of a working capital loan that is not fluctuating and is often the reason behind banker-client disagreements. Ideally, if the business is carrying out the majority of its daily transactions through its working capital loan account, the balance outstanding to the bank over the course of time should show fluctuation (go up and down). However, due to either the poor management of the working capital loan by either the banker or the client, or a general lack of profitability in the business, withdrawals sometimes accumulate faster than deposits, and the balance

Figure 1 Permanent Working Capital

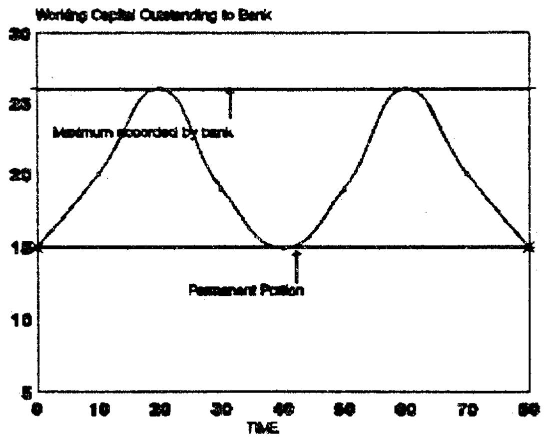


Figure 2 Temporary Working Capital

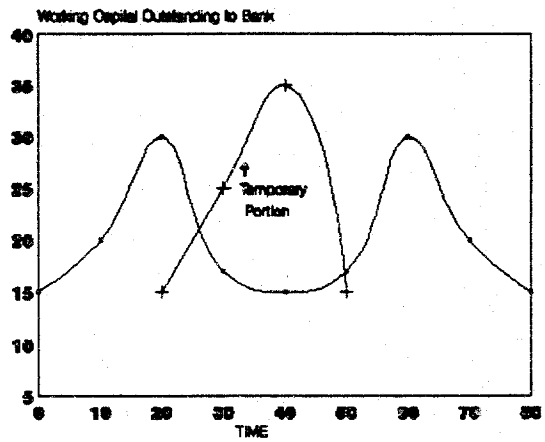
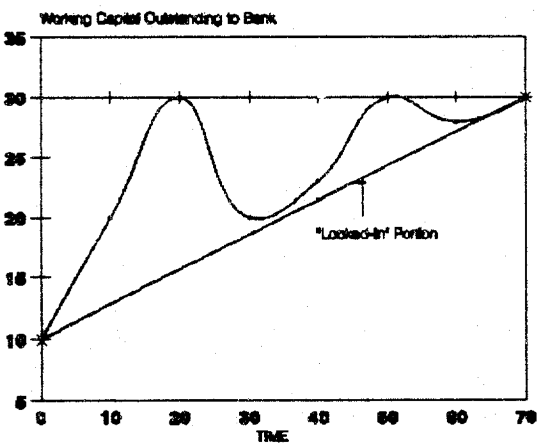


Figure 3 Locked-In Working Capital



outstanding to the bank increases over time. This leaves less and less available to the business to meet its daily requirements, and, as a result, the owner often complains of a lack of working capital. The "locked-in" portion would be the amount that is not fluctuating. (See Figure 3).

5.2.2 Sources of Working Capital

Working capital can come from either a loan to the business or from equity (retained earnings and savings). In the case of the former, it could originate from either the formal or the informal sector. From the formal sector, it could come in the form of a bank loan, from the raising of equity by selling shares or issuing bonds, or from other institutions like leasing companies. From the informal sector, working capital can be raised through the use of supplier credits, loans from money lenders, advances from buyers, and gifts or loans from friends or family. Within the formal banking sector, the funds to provide working capital to businesses come from a global pool of funds that is made available to the banking system through monetary supply mechanisms.

The money supply in free market economies is usually controlled through the setting of interest rates at which the government will borrow short- and long-term funds. This is a benchmark that allows banks to determine what rates to pay for deposits and to charge their borrowing clients. To constrain the growth of credit, central banks can raise interest rates, making investments less profitable and savings more attractive. By reducing the rates, they try to encourage investment, thereby allowing the money supply to expand. With this system, funds for debt financing are usually always available, although the cost and amount fluctuate. This system does not effectively control what types of loans are made. Rather bankers are left to determine where their best risk/reward levels lie and to lend to any sector with any type of loan (long-, medium- and short-term).

Monetary authorities can also control credit by rationing credit available to the banking system through either the establishment of ceilings and targets or by adjusting the reserve requirements[121]. In the case of the former, the authorities can legally impose upon banks targets that the banks must achieve or ceilings that they cannot exceed. Breaking the ceiling or not achieving the target will usually result in stiff penalties. In this system, the amount of capital available for financing could indeed be constrained. Since working capital is a portion of the total available capital, it could also be in short supply, especially in sectors where risk is deemed to be relatively higher.

Due to their normally short term funding base (savings accounts and term deposits), commercial banks prefer to lend shorter term. As a result, in most countries they provide the majority of the working capital and medium-term loans (2-5 years). These same banks usually do not lend for purposes in excess of 5 years, although through a process known as "evergreening" can renew loans at regular intervals, thereby achieving the same results as a

---

[121] Reserve requirements are usually percentages of different types of deposit instruments that the monetary authorities oblige the banking system to deposit in the custody of the central bank.

long-term loan. Other institutions including NBFIs will lend longer-term funds and may be major suppliers of permanent working capital. Rarely will they offer purely working capital loans, as they are usually not set up to handle the volume of transactions that is involved with the administration of a working capital loan.

The informal sector is active in most countries, and a recent study has confirmed that the sector is alive and healthy in Pakistan.[122] This sector is made up of family, friends, money lenders and suppliers. It has proven to be quite dynamic and is a source of readily available high-cost capital. However the turnaround time is rapid, sometimes immediate. Terms include both short and long, and conditions will vary highly. Supplier credit is often made available to good long-time clients at slightly higher rates than the formal sector, but lower than the informal sector and are usually for a short period of time (30, 60, or 90 days).

In a competitive situation, working capital to agribusinesses should be available from at least one of these sources, although the cost will vary. In a situation where credit is being rationed and directed at the same time, a real shortage of working capital could quite easily exist.

5.2.3 Assessment of the Need for and Use of Working Capital

In the case of an ongoing business, the standard procedure for approving a working capital loan is based on an analysis including: the length of the business cycle, the indebtedness of the client, the repayment history of the client, the character of the client, the profitability of the business, the security available to protect the loans, the duration of the banker-client relationship, and the stability of the business. The banker can then, if funds are available, make a proposal to the client including conditions (amount, rate of interest, security required, monitoring procedure to be employed) upon which the loan will be granted.

The security requested is assessed on a case-by-case basis. However there is usually a pledge of liquid assets (raw materials, inventory, accounts receivable) taken in addition to a lien on some other security (plant, machinery and/or land). The liquid assets pledged are never taken at their fair market value. Rather they are margined; that is, only a portion of their value is taken as a measure of collateral against the loans, e.g., 75% of the fair market value of raw materials and finished inventory, 50% of the estimated value of work-in-progress, and 75% against the actual value of accounts receivables not older than 60 days.

Often the unmargined total value of the liquid assets is greater than the loan amount, and the client feels that the bank is oversecured. This is where the assessment of risk comes into play. The banker has less control over the liquid assets of the company than over a building or land. Inventory can be sold for cash, and the company can actually dispose of all liquid assets quite quickly without the banker's knowledge. Thus the banker margins the different

---

[122] Hussein, 1991.

components of liquid assets according to a "safe" valuation and then takes additional security. If the client gets into a bind and requires additional working capital, and neither his banker nor another banker wishes to advance additional funds, then a real shortage of working capital exists for this business. The options are to continue to try and negotiate a loan, reduce business operations, or arrange credit from the informal sector. If the business is technically healthy and the problem lies mostly with the banker and his analysis, then in a competitive environment the client should be able to find another institution to take over his financing.

In the case of a start-up, astute financiers motivated by competition will undertake a detailed cash-flow analysis to determine what level of initial (permanent) working capital is required to start the business, i.e., to build up the level of inventory, cover the operating costs for the first production cycle, and grant credit to purchasers. This amount of capital will then be financed via a combination of equity and either a medium- or long-term loan. The remainder will come from a regular short-term working capital loan. If the analysis is not carried out and the maximum amount of capital required is financed via a working capital loan, within a very short period of time a portion equal to the permanent working capital required will effectively become the lowest point to which the loan will fluctuate. As long as everybody understands that this now "locked-in" portion of the loan is legitimate, then there is no problem. However, if the rate of interest is higher on the working capital loan than the long- or medium-term loans that were used to finance the start-up, then it will be costing the business to keep this portion of capital in the working capital loan. In practice, both ways work; the former is the correct way and makes the evaluation of the performance of the business a lot easier.

Controversy between a banker and his client may occur when the latter uses his working capital loan as "one big credit card." He makes purchases that are really long-term investments (a tractor, additional land) and as a result, that portion of the loan is not available to carry out the daily operations. Faced with a shortage of cash, the entrepreneur should approach the banker to refinance the purchase through a separate loan, thereby replacing the funds to the working capital loan. However, the entrepreneur may only realize the problem once there is no more working capital loan left. Usually the banker will refinance after the fact at least once. Repeated occurrences will lead the banker to believe that the client has a problem in managing the funds, and, as a result, the banker feels that the risk is increasing. Eventually he will not refinance. Thus the entrepreneur runs short of working capital and has to struggle on a day-to-day basis to manage the cash position of the business. This often leads the owner of the business to complain of a shortage of working capital. It sometimes forces the business to the higher-cost informal market, thereby effectively reducing his profit margins and further aggravating the problem. If the business is highly profitable and the production cycle is short or non-existent, this practice is tolerable. However, these types of businesses are usually commercial (import/export, retail), not productive.

A legitimate need for increased working capital often arises when a business enters a period of rapid growth. When a business grows quickly it has a thirst for working capital as levels of inventory increase (both raw materials and finished product). In this case, both the banker and the client have to be astute enough to recognize the situation and make the necessary working capital arrangements. Larger corporations are usually sophisticated enough to project growth levels and make the necessary financial arrangements well ahead of time. Rapid growth affects many smaller businesses, however, who do not necessarily practice forward planning and as a result are often constrained by a lack of working capital. If the client-banker relationship is close, then the banker can recognize what is happening and act to ensure that a lack of funds does not slow the growth of the business. It should be noted that even with sufficient funds, rapid growth in a small business can often be stalled by an overwhelmed and underequipped management team.

In summary, a shortage of working capital can be the result of:

- The global supply and demand situation for credit,
- Central bank intervention through the directing and rationing of credit,
- Bankers' assessments of clients' needs, and
- Clients' use of working capital.

5.3 Pakistan's Credit System vis-a-vis Agribusiness

5.3.1 Brief History[123]

The scheduled banking system in Pakistan, which has historically accounted for over 85% of the loan advances in the credit system now consists of:[124]

- One public sector commercial bank: National Bank of Pakistan,
- Two NCBs: United Bank of Pakistan and Habib Bank Limited,
- Two recently privatized NCBs: Allied Bank of Pakistan Limited and Muslim Commercial Bank,
- Five specialized banks: First Women Bank Limited, Agricultural Development Bank of Pakistan, Federal Bank for Cooperatives, Industrial Development Bank of Pakistan, and Punjab Provincial Cooperative Bank Limited, and
- Twenty foreign commercial banks.

The NCBs have been in operation since the 1950s, most starting out private. They were nationalized in the 1970s, and are being privatized in the 1990s.

In addition, there are now:

- Ten newly created private scheduled banks,
- One provincial bank, Bank of Punjab,
- Eight NBFIs: Pakistan Industrial Credit and Investment Corporation, National Development Finance Corporation, National Development Leasing Corporation,

[123] A detailed description is given in Klein, 1991.

[124] State Bank of Pakistan, 1990-91 annual report.

Regional Development Finance Corporation, Investment Corporation of Pakistan, Bankers Equity Limited, Small Business Finance Corporation, and House Building Finance Corporation.

The SBP also refers to the following mix of specialized banks and NBFIs as DFIs: ADBP, IDBP, FBC, PICIC, NDFC, NDLC, RDFC, ICP, BEL, SBFC, and HBFC.

The GOP started to use the financial system in the 1960s to attempt to achieve various socioeconomic goals. The Credit Enquiry Commission in 1959 precipitated the idea that private interests and market forces should give way to social and economic goals as defined by the GOP. This led to more restrictive controls and regulations and the eventual formation of the NCCC. The NCCC designed monetary policy and eventually led to the use of mandatory credit targets as a means of achieving development objectives in certain sectors. During this same period, in a parallel effort to meet the various social and economic goals, several specialized NBFIs were formed.

In an effort to deal with the mounting problems of non-performing loans and to deal more effectively with the social and economic reforms, the banks were nationalized in 1972 by the first Bhutto government. The deposits of the NCBs were insured, and the PBC was set up to supervise the NCBs in line with GOP policy. During the first Bhutto period, the banking system expanded in terms of branches, loans, and deposits. This growth decreased when the Zia government began to allow the financial sector to slowly return to a market-driven system. During this same period, 1978 to 1986, more foreign banks were opened.

During the mid- to latter 1980s, the SBP conducted an in-depth analysis of the quality of the portfolios of the NCBs. Their worries were confirmed, namely that the non-performing loans were continuing to rise. This led to the formation of a bank reform program and many of the changes that underway today, including a reduction of interest rate subsidies, permission to NBFIs to mobilize deposits directly, the issuance of prudential regulations, the licensing of new investment banks, and the privatization of some of the NCBs.

5.3.2 Sources of Agribusiness Credit

Lending to agribusiness and its subsectors has been carried out by a number of institutions, including the commercial banking system. Table 5 breaks down lending to the entire agricultural sector by the scheduled banking system as of June 30, 1991. It shows that credit to the private sector is over three-fourths of the total advances. The agricultural sector gets 38% of the total advances, and agribusinesses, 20% of the total credit available. Credit to production agriculture accounted for 17% of the total scheduled bank credit. The largest single agribusiness sector is textiles, taking 15% of total credit, equal almost to that of agriculture.[125]

[125] Textiles includes ginning, spinning, weaving and some finished garment operations, but not the made-up category.

Table 5 Pakistan: Scheduled Banks' Advances to the Agricultural Sector (As of June 30, 1991)

(Millions of Rupees)

Borrower	Total Loans		Commercial Banks		Specialized Banks	
	Amount	%	Amount	%	Amount	%
Agriculture	39,201	17.61%	3,750	9.57%	35,451	90.43%
Agribusiness:						
Food	8,125	4.65%	6,362	78.30%	1,763	21.70%
Beverage	1,572	0.71%	1,523	96.88%	49	3.12%
Tobacco	735	0.33%	721	98.09%	14	1.91%
Textiles	33,618	15.10%	29,939	89.06%	3,678	10.94%
Leather	1,596	0.72%	1,471	92.16%	125	7.84%
Total Agribusiness:	**45,646**	**20.50%**	**40,016**	**87.76%**	**5,629**	**12.24%**
Tot. Agr. Sector:	**84,847**	**38.11%**	**43,766**	**51.58%**	**41,080**	**48.42%**
Tot. Priv. Sector:	**172,522**	**77.48%**	**120,071**	**69.60%**	**52,451**	**30.40%**
Total Advances:	**222,659**	**100.00%**	**165,983**	**74.55%**	**56,676**	**25.45%**

Source: State Bank of Pakistan, 1990-91 Annual Report, pp. 38-39.

Clearly the agricultural sector is a large user of credit in the system, and credit to agribusinesses is highly concentrated in one sector, textiles.

A closer examination of the roles of the commercial and specialized banks in the system shows that the bulk of the loans to production agriculture (90%) was outstanding to the specialized banks, while the bulk of the advances to agribusiness (88%) was owed to the commercial banks. Of the amount lent to agriculture from the specialized banks (ADBP, FBC, IDBP, FWBL and PPCBL), most of this amount comes from the ADBP and FBC. Of their totals, ADBP disbursed only Rs. 2.5 billion and FBC, only Rs. 3.0 billion of short-term loans (working capital), throughout the year. Given that working capital loans fluctuate and that these amounts were disbursed throughout the year, the majority of the credit coming from the specialized banks is of a long-term nature. On the other hand, given the short-term funding arrangements that most commercial banks have, we can conclude that the commercial banks are providing a major portion of the advances to agribusinesses as shorter-term loans. Also given that the agricultural production loan scheme amounts to some Rs. 2 billion, it can be concluded that the commercial banks furnish few short-term loans to agriculture outside of what they are obliged to provide under this scheme. On the other hand, they have not had a problem lending for the short term to agribusinesses.

In discussions with the specialized banks and several clients, it was reported that in several cases during the application process the amounts allocated for working capital in the applications were reduced. At times this was due to the official policy of the institution, and at times it may have been exaggerated. The only way an institution can properly analyze the working capital requirements of a venture is through a detailed cash flow analysis. Similarly, the only way that a project should be financed is with all of the required financing in place before beginning the project. It is highly doubtful that the institutions practiced detailed cash flow analysis; it is also highly doubtful that the proposals coming forth from their clients contained pertinent and detailed cash flow projections. As a result, the institutions generally did not deal adequately with the working capital component of the project financing.

Several studies have indicated that the informal sector provides farm production with at least 70% of its requirements.[126] An undetermined portion of the informal sector is agribusinesses, from which farmers receive credit and advance payments. If agribusinesses did not finance some of the activities of the farming sector—because the latter could obtain sufficient financing from other sources—this would reduce the working capital requirements of agribusinesses.

In conclusion, the working capital needs of the farming sector are being met in a large part by the informal sector, of which agribusinesses are a part. The scheduled banks' advances to agribusinesses are highly concentrated in the textile area,[127] and the only other sector that would seem to get working capital financing, through the NDFC, is sugar. This leaves the remainder of the sector to either finance their working capital requirements through equity, the informal market, or go without.

5.3.3 Recipients of Credit by Size of Loan

In addition to the subsectors receiving credit in the system, one can examine the distribution of these loans by size. Unfortunately, the only figures that are available are for the private sector as a whole and not for its individual components. However, given that agribusiness takes up over 50% of the credit advanced to the private sector, the relationship seen in Figure 4 probably holds for agribusiness as well.

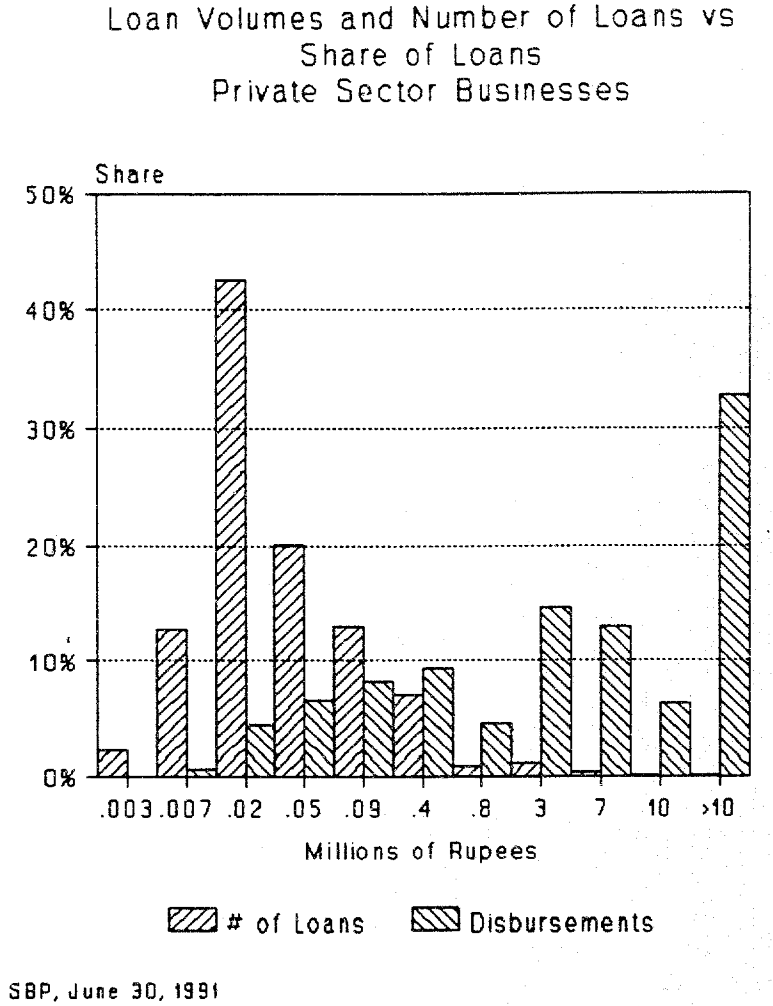
---

[126] Scott and Redding, 1988, and Hussein, 1991.

[127] Moreover, much of the credit to textiles goes to those industries from weaving onward, which cannot be considered agribusinesses.

Figure 4 shows a typical relationship between the numbers of loans and their portion of the total credit extended. Smaller loans account for a large percentage of the number of accounts, but a small percentage of the total loan volume. The situation is reversed at the other end of the graph, where loans in excess of Rs. 10 million account for only 0.13% of the client base, but over 30% of the funds advanced. This indicates that the commercial banking system, with its branch organization, does deal with a large number of small and medium-sized businesses, although their exposure to this sector is not large.

Figure 4 Pakistan: Loan Volumes and Numbers vs. Shares, Private Businesses



From the graph, 9.5% of the number of accounts use 80% of the credit in the system, leaving 20% or Rs. 34.5 billion to 1,444,208 borrowers or Rs. 23,888 per borrower. Thus small and medium-sized businesses are not getting a very large portion of the total credit in the system. If the assumption is made that agribusiness clients have the same distribution as other sectors, small and medium-sized agribusinesses do not get much of the credit from the scheduled banking system. Working capital is a part of the total capital available, so they also get much less of this.

5.3.4 Non-Bank Sources of Capital

Leasing companies. Leasing companies began operation in the 1980s. In 1992 there are 10 companies listed as leasing companies on the KSE, and of the 30 or so *modarabas*, 12 are leasing companies. These companies have raised their capital on the KSE, usually with the backing of a public sector institution or a large industrial group. Operating and long-term credit lines have been arranged through the banking system, with a wide variety of banks participating. In addition, ADB, the World Bank and AFIC have provided long-term loans to these institutions. More recently they have received sanctions to raise their own deposits.

Table 6 Pakistan: Breakdown of Investment by Selected Leasing Companies, 1992

Type of lease	Company No. 1	Company No. 2	Company No. 3
Vehicles	38%	43%	47%
Plant & Machinery	56	49	48
Office Equipment	6	8	4
Buildings	0	0	1
Total	**100%**	**100%**	**100%**
Share of Portfolio in Agribusiness:			
Cotton & Textiles	37%		26%
Sugar	3		5
Food & Beverage			4
Tobacco			1
Leather Goods			1
Total	**40%**		**37%**

Sources: Leasing company management, personal communications.

Leasing companies are important to agribusinesses in various ways. The first is that the tax code allows the company to write off all of the lease cost, which is usually substantially more than the depreciation charge allowed. Secondly, they can free up working capital, by reducing the amount that is required for the equity portion of an investment and through sale-leaseback arrangements. When a business makes an investment in equipment or machinery, there is usually at least a 30% equity injection required. Under a lease arrangement, the business can reduce this to a maximum of a 10% down payment. Under a sale-leaseback arrangement, a firm can sell a portion of its assets to a leasing company, which then leases the assets back to the firm. The cash from the sale can be used by the company as working capital.

The portfolio characteristics of three leasing companies that were visited are presented in Table 6. Although a large portion of the leasing companies' activities are in the vehicle business, they also have a significant portion in machinery and equipment. In addition, the total exposure to the agribusiness sector is significant—close to 40%—for the two companies for which detailed figures were available. In a significant development, one of the companies has just been granted the use of a $26 million line of credit to arrange leases for the micro and small business sectors (less than 10 workers and less than Rs. 10 million in assets outside of land and buildings), across all types of enterprises, including agro-based industries.

The introduction of leasing companies into the financial system will prove positive and will be an additional source of medium- and long-term financing to agribusinesses. In addition, they can play a role in reducing the amount of working capital required by an agribusiness from the banking system by reducing the amount of equity that is required to make an investment. The one drawback may be that leasing companies do not finance start-ups, which will eliminate the leasing alternative from those available to a start-up agribusiness.

Stock Markets. There are two exchanges in Pakistan, one in Karachi and one in Lahore, the former being the more active and larger of the two. The markets have seen a large amount of activity in the past two years. The capitalization of the stock markets increased by 206% in the first six months of 1991/92 and more importantly the turnover increased by 51%, marking the development of the all-important, secondary trading market. The Index (State Bank of Pakistan, 1980 = 100) has risen from 317 (March, 1991) to 783 (January, 1992), and during the same period the capitalization increased from Rs. 55 billion to Rs. 208 billion. Factors which have contributed to the increased activity on the equity markets include the announcement of positive changes in February, 1991 to investment regulations and in particular an influx of foreign investment.

While long-term forecasting of stock market activity is hazardous, some statistics on the KSE show that agribusinesses are making good use of this source of capital. As of June 30, 1991, the total market capitalization was Rs. 68.4[128] billion of which: cotton textiles had Rs. 11.7 billion (17%); sugar and allied industries had Rs. 4.3 billion (6%); tobacco had Rs. 1.4 billion (2%); and edible oils had Rs. 0.5 billion (1%). Thus in total over 25% of the capitalization on the KSE is accounted for by agribusiness firms. Other agribusinesses like fertilizers and equipment manufacturers are not listed independently, so the actual figure is higher.

The continued development of the stock market will provide a direct alternative for the financing of large-scale agribusinesses. Through small investor participation in *modarabas*, it will provide an indirect alternative for small and medium-sized agribusinesses through leasing operations. By taking advantage of these alternatives, agribusinesses can reduce the amounts of funds that they require from scheduled banks.

Informal Sector. As in most developing economies, the informal sector is probably the most dynamic and the hardest to measure. A recent study of the informal sector has revealed some interesting facts about the capacity of this sector.[129] It has developed its own set of services, rules, and regulations, and represents a quick alternative to formal sector credit.

---

[128] State Bank of Pakistan, 1990-91 annual report.

[129] Development Research and Management Services (Pvt) Limited, 1991.

This usually manifests itself in the cost of capital. Interest ranges from 20 to 48% per annum, but there are no fixed repayment schedules, no collateral given, lower transaction costs, no appraisals, no administration fees, and quick service.

Borrowers from the informal sector include the transportation sector, where rates exceed 10% per month; businessmen who require operating capital and are willing to pay 2 to 4% per month; and microenterprises, whose largest supplier of credit is the informal sector, at a cost of 2 to 15% per month. The fact that businessmen, considered relatively lower risks, borrow at rates of 24 to 48% per annum leads one to believe that demand might outstrip supply. As was mentioned above, about 70% of the credit to the agricultural sector came from the informal or non-institutional sector. Smaller farmers obtained more that 90% of their credit from this sector, while the larger farmers obtained a substantially lower amount (40%).

The informal sector will continue to operate as an alternative to the formal banking sector. The cost of its credit to the user is a limiting factor to extensive use by any particular sector, however. Because of its cost, informal credit only allows a level of survival, the borrower often being held "hostage" to the lender through buy-back arrangements. The informal sector is likely to continue to play a very important role in at least maintaining the agricultural sector at its present levels of production.

Another credit alternative is Grameen Bank or community lending, where the costs are effectively less. Among institutions trying to implement this system are the ADBP, through a World Bank/IFAD initiative, and BOP and MCB, through special programs on unsecured lending to rural microenterprises.

5.3.5 Summary

Table 7 summarizes sources of capital available to each type of agribusiness, and represents a qualitative determination of who supplies each type of capital. SBP changes its definition of "small" according to the institution and does not have a definition for "medium-sized" businesses. For this table, "small" means loans less than Rs. 5 million; "medium," Rs. 5 million to Rs. 50 million; and "large," above Rs. 50 million. These limits are not binding; i.e., an institution that lends to large agribusinesses could lend to a medium-sized agribusiness, although the major portion of their business would be to the larger sector.

The ADBP annual report for 1991 shows that the outstanding amount to agribusiness at fiscal year end was Rs. 5.6 billion (only 15% of assets). Over 95% of their loans disbursed in 1990-91 were below Rs. 500,000. The Rs. 587 million disbursed for project purposes (only 7% of amount disbursed) went to finance 116 projects (average of Rs. 5.0 million per project), indicating that ADBP is on the borderline. However, ADBP will be de-emphasizing agribusinesses as a part of their target market.[130] As a result, they have been classed as an

[130] Javed Talat, Chairman, personal communication.

institution financing the lower end of agribusiness. NDFC, on the other hand, assisted 69 projects in 1990-91 for a total of Rs. 4.2 billion or an average of Rs. 60 million per project. (Their lower limit is a project size of Rs. 50 million).

The average loans approved for 1990-91 for PICIC, IDBP, and SBFC, were Rs. 127.8 million, Rs. 14.8 million and Rs. 0.095 million, respectively. These institutions also lend funds for working capital purposes; their exposure in agribusiness and agriculture varies. PICIC is concentrated in the textile subsector, IDBP has about one-third of its portfolio in various agribusinesses, and SBFC does not loan to agribusiness. Investment banks that were interviewed indicated a minimum project size of Rs. 100 million. Based on the existing array of financial institutions, there appears to be a need for a specialized institution to service the small and medium-sized agribusiness sector.

5.4 Credit Issues[131]

5.4.1 Monetary Control Through Directed Credit

During the past 20 years, the NCCC exercised monetary control through the imposition of reserve requirements and credit ceilings and targets. This was accomplished through the development of an annual credit plan, which set the limits for the expansion of the money supply and directed credit to various priority areas. It is this directing or rationing of credit that has probably had the largest effect upon the overall availability of credit.

The NCCC would instruct the banking sector what percentage of reserves the individual institutions would have to keep on deposit with the SBP, how much they should invest in treasury bills, and how much they should lend via directed credit. Anything that was left was available for non-targeted private sector uses. Today the banks have to keep at least 35% of their assets on reserve with the SBP;[132] this amount of deposits is automatically taken away from the potential pool available to the private sector. Most countries use this system of reserve requirements, although the percentage is often much smaller. In LDCs, the percentage is often high, generally due to governments' high levels of borrowing. This has a generally negative effect upon private investment in those countries.

[131] *Riba* is an Islamic concept of interest (on capital). While future developments in Pakistan centering around *riba* may be very important to all those giving and receiving credit, it is beyond the scope of this paper to examine this issue. Until now Pakistan has succeeded in developing an Islamic banking system (including profit and loss sharing). The implicit assumption of this study is that such development will continue and the operation of a banking system will not be precluded.

[132] For the July-September, 1992 quarter, the credit deposit ratio for banks was 30% of the bank's average weekly local currency deposits and 40% of the average weekly foreign currency deposits. SBP, BCD Circular letter no. BCD(CC)/14/127.Priv.92, dated 27 July, 1992, para 3.

Table 7 Pakistan: Sources of Formal Sector Credit, 1992

Sector	Agriculture						Agribusiness					
Size	Small		Medium		Large		Small		Medium		Large	
Type of Credit	W	T	W	T	W	T	W	T	W	T	W	T
Source												
NCBs	Y		Y		Y	Y			Y		Y	
Foreign banks											Y	
ADBP	Y	Y	Y	Y	Y	Y	Y	Y				
Cooperatives	Y	Y					Y	Y				
IDBP									Y	Y		
SBFC								Y				
PICIC											Y	Y
NDFC											Y	Y
IFC											Y	Y
Investment banks											Y	Y
Stock Market											Y	Y
Leasing Cos.								Y		Y		Y
Informal	Y		Y		Y		Y		Y		Y	

W = working capital; T = term loans

Whatever was left over after the targets were set was available for the banks to lend, and a portion of that was available for working capital. Targets set were both minimum and maximum, with a penalty paid if the targets were exceeded (maximum) or not achieved (minimum). Usually this penalty was an amount equivalent to either the shortfall or the overshoot to be deposited with the SBP at 0 percent interest. Through this direction of credit and high reserve requirements, the GOP effectively controlled interest rates on both deposits and lending. Banks had no incentive to finance higher-risk ventures and found it easier and less risky to simply invest in government bills. The result was a system that was not generally responsive to market opportunities and that avoided risk.

The critical issue which faces the financial sector today is whether or not the Government will revise this system. Under an agreement with the IMF, the SBP is obliged to gradually reduce directed credit programs. If it chooses not to remove these programs, it will risk not only losing IMF support, but also seriously constraining the improvements to the banking system that privatization could bring.

As of this writing, the position was as follows. The Government decided to

> ...discontinue the existing system of credit ceiling for individual banks with effect from 30th July, 1992. From then on, the State Bank shall regulate credit expansion in the commercial banks through open market operations, changes in cash reserve and liquid assets requirements as aiso (*sic*) fixation of credit deposit ratios.[133]

In the same circular the SBP has defined "credit for the purpose of regulating private sector proper credit through credit deposit ratio" as "**excluding** credit extended to the Public Sector Enterprises, Cotton Export Corporation for purchase of raw cotton," and other such uses of credit by the public sector. It further states that

> The mandatory targets, amount earmarked for fixed industrial investment and the maximum limit for housing finance shall be indicated to each bank separately. Credits to these priority sectors shall form part of banks private sector proper credit regulated by credit deposit ratio.

Mandatory credit targets for commercial banks were recently specified by the NCCC in the following areas: "Agriculture; Small Loans (agricultural production, small business, and small industry); and Loans for Tobacco Marketing."[134] Each target is more then Rs. 1 billion for the July-December, 1992 period.

The upshot of these statements and actions is not yet clear. While the Government states that it is abolishing the old system, many of the elements of that system are perpetuated. Public and private credit are still treated differently, and there are still credit targets for priority sectors. The credit system has had a pervasive impact on the economy in Pakistan, so it is not reasonable to expect major changes to occur rapidly.

If the system changes and credit is free to flow to the areas where the bankers feel they are optimizing their risk/reward position, the relative importance of agribusinesses will become evident. Bankers will mostly likely continue to support the textile sector, but not immediately venture into higher-risk areas. This situation may change if there is increased competition due to the arrival of ten new banking institutions on the market. However, before going to agribusiness, these institutions may aggressively compete for whatever good business is in the market, so they will resort to stealing clients from other institutions through the use of interest

---

[133] SBP, BCD Circular letter no. BCD(CC)/14/127.Priv.92, dated 27 July, 1992, para 2.

[134] Minutes of NCCC meeting, July 25, 1992.

rates. Then if they still have funds to lend and the government rates (T-bills) are not attractive, they will begin the search for higher-risk ventures.

For agricultural producers, as long as the DFIs (specialized banks) continue to receive funding and raise deposits and given that the informal sector is their largest supplier of credit, little change in availability would be expected. The only change may be in the cost of funds.

5.4.2 Credit Schemes

In order to assist certain sectors of the economy, the GOP initiated several credit schemes. These were efforts to stimulate certain sectors through low-markup loans and high debt-equity ratio requirements. These included LMM, Credit for Small Farmers, the Small Loans Schemes and industrial zone incentives. Credit under these schemes represented about 10% of the credit outstanding to the private sector as of June 30, 1991.[135]

Such schemes are often ineffective, as most of the funds tend to fall into the hands of people who are not in the targeted sectors. Low-interest loans are basically an attraction to anyone who is investing, and are usually fungible. In the case of the low-markup or markup-free loans for small farmers, a large portion of these funds were lent to the larger landlords in the name of the small farmers, and it is unclear what percentage actually went into the production of an agricultural commodity. The bankers interviewed were unanimous in their assessment that the credit schemes did not accomplish their goals and were highly misused.

The scheme to purchase tractors from the nationalized equipment producers resulted in tractors being used for commercial transport instead of working the land, and small farmers who couldn't justify their use having tractors. Once the schemes were cut back, the sales of tractors slowed dramatically.

Using high debt-equity ratios as a means of attracting investors is a dangerous tool. These ratios were used to attract investors to depressed areas and into sectors where the GOP felt that investment was justified but not being made, in other words, areas where the risks of investment were higher. By doing so, the Government encouraged overinvoicing, in which the investor inflates the value of the investment. As a result the investor often received 100% financing. Here the GOP broke a cardinal rule of finance. If an investment is risky, equity should be increased and not debt. The most salient result was that the credit schemes took available credit out of the system and allocated it to higher-risk ventures whose financial or economic paybacks were questionable.

Under the schemes, banks received mandatory targets and at the same time were compensated for additional risk by being given a 50% guarantee from the SBP. The guarantee is an issue in contention, as the NCBs have been compensated only for the losses incurred

---

[135] Described in SBP, Annual Report 1991.

between 1972 and 1979 but not at all for the losses incurred since 1980. In fact the SBP negotiated a package with all of the banks at 25% of the amounts and not 50%. This has obviously proved costly to both the banks and the SBP.

Finally, the privatized NCBs and the new private banks maintained that the SBP could not continue to enforce either directed credit programs or credit schemes upon them. However, the SBP and the still NCBs maintained that the SBP can do so and will continue to do so, because of political intervention. However, under an agreement with the IMF, credit schemes are to be eventually eliminated and according to one SBP official, will be eliminated at the end of the current fiscal year (1991/92).

In conclusion, directed credit and subsidized credit schemes have proven to have higher economic costs than benefits in other countries.[136] Interest as a part of the total cost of production inputs is relatively small, so cutting down on interest cost has little impact on the profitability of the farm. On the other hand, the government must bear the cost of both subsidization and non-repayment.

5.4.3 Working Capital

The Pakistani financial community describe their conditions for financing working capital as similar to those in section 5.2.3 of this chapter. They tend to agree to a 50-70% margin (ratio of loan to inventory), but none takes only a pledge of inventory as collateral against an operating line of credit. They normally request additional security. Bankers indicate that in industries like feed milling, where the miller is forced to sell his product on credit, the ratio of loan to inventory was around 50%, whereas for a hatchery operator who sells on a cash basis only, the margin would be higher at 70%. If this is so, then bankers are properly assessing the risk and taking preventative measures to reduce their potential losses.

Although bankers agreed that in general a shortage of working capital was a problem, they all felt that the needs of genuine borrowers were being met. However, one must remember that the banking system did not include much competition in the past. Bankers and clients were directed to each other, and there was little assessment of capital needs. Thus it is not surprising that bankers would feel that all of their good clients were getting what they need.

One way to assess whether or not there is a shortage of working capital among agribusinesses is to compare the supply of short-term credit with the demand. Because available data on the supply of advances are not disaggregated into long- and short-term loans, however, this comparison is not easy to make. Advances to private agribusinesses come mostly from the commercial banks, but some of these advances may not be for working capital. The demand for working capital can be estimated by the variable costs incurred by agribusinesses. Data on these costs are published in the Census of Manufacturing Industries, the latest edition of which

---

[136] Scott and Redding, 1988.

Table 8 Annual Variable Costs of Private Agribusinesses, 1990-91

	Industrial and Employment Costs (1986-87) (1)	GDP Deflator, Market Prices (2)	Estimated Industrial and Employment Costs (1990-91)
	(Million Rs.)		
Food	29,220	1.43	41,785
Beverage	1,035	1.43	1,480
Tobacco	1,886	1.43	2,697
Textiles	28,033	1.43	40,087
Leather (3)	4,671	1.43	6,680

(1) The industrial & employment costs are the sums of employment and industrial costs.

(2) The GDP Deflator represents the percentage increase in market prices between 1986-87 and 1990-91. The price index for 1986-87 was 142.49, which had increased to 204.31 for 1990-91 (Base 1980-81=100).

(3) Leather includes leather products.

Sources: Federal Bureau of Statistics, Census of Manufacturing Industries, 1986-87; Finance Division, Economic Survey, 1990-91.

includes data for 1986-87. To compare these data with the latest available credit data, the costs are updated to 1990-91 by inflating them by the ratio of the respective GDP deflators. The data available are the total annual variable costs. Normally, however, a business would turn over its inventory and/or pay its bills for operating costs more frequently than annually. Thus it would not require a credit line equal to its total annual variable costs; its requirement would be considerably less.

The comparisons in Figure 5 should therefore be interpreted very carefully. On the one hand, the supply of working capital may be overestimated, while on the other, annual variable costs clearly overestimate the demand. The ratio of annual variable costs to the size of a working capital credit line needed is likely to range between 1 and 12. A spinning mill might turn over its raw material inventory once per year, while virtually all enterprises would have monthly bills for labor, energy, and other production inputs. The ratios of costs to advances range from 1.0 for the beverage subsector and 1.3 for textiles to 6.6 for food. We can deduce from Figure 5 that the textile and beverage subsectors are well supplied with working capital: their supply of capital is equal or almost equal to their annual variable costs. The other sectors are less well supplied, with food (manufacturing) receiving the least capital as a proportion of variable costs.

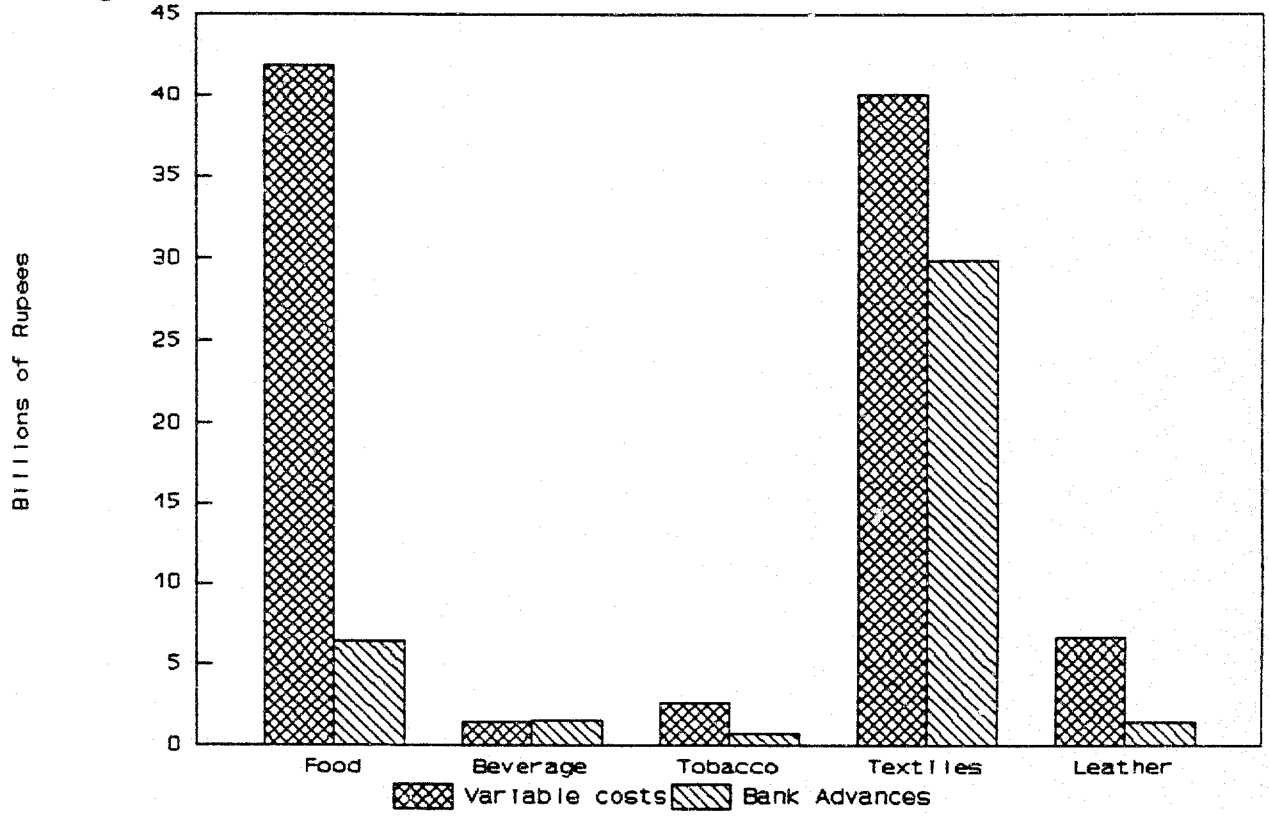
One of the agro-industrialists interviewed indicated that the GOP policy of domestic price stabilization in sugar affected his enterprise seriously in the last season by limiting the amount of credit that the bank could advance him against sugar stocks. The GOP allowed sugar imports during the processing season, thereby lowering the price and forcing the operator to store, but he did not have sufficient bank credit to store. The entrepreneur made other arrangements for the needed credit, but the cost increased substantially. This type of intervention adversely affects the banker-client relationship and adds to a deterioration of the banker's confidence in dealing with the agribusiness sector.

The Government has done this in other sectors, too. It has regulated lending margins against stocks of basmati rice and stipulated the value of cotton stocks. The Government restricts advances of banks against agricultural stocks or arbitrarily changes the price to control speculation in these commodities and control domestic prices. This is counterproductive, however, to allowing credit to flow to where it is most productive. This type of intervention would cause the banker to lower the margin automatically because he cannot depend upon only the market price to value the security he holds. If the GOP wants to control speculation, then allowing market forces to determine when a commodity should come into the country is a good alternative. Interfering with the banker-client relationship will only retard the growth of both the banking sector and agribusiness.

Another scheme which bears on the issue of working capital is export refinance. Under this scheme an exporting company can get an advance on either fixed orders or confirmed shipments up to 100% of the value of the order at 7% interest. This is an efficient way of injecting working capital into a system that is short of working capital. On the other hand, the incentive of low-cost capital in high demand would encourage activities such as overinvoicing, thereby increasing the cost of this program. To resolve this problem there are two options: continue with the program and enforce better controls on overinvoicing, or increase the supply of working capital at market rates.

Working capital for businesses in Pakistan, in particular agribusinesses, is definitely a problem. It is the magnitude of the problem, or the shortfall between supply and demand, that is difficult to estimate. The high cost of credit to business from the informal sector is one indicator that working capital demand is stronger than supply. Another is that in the past, credit had to be rationed. The situation with the small and-medium sized agribusinesses seems to be the most severe and the area where supply will continue to be a problem for the immediate future, despite increased competition. Bankers will look for more solid business first (compete on interest rate) and then if funds are still available, look at these relatively higher-risk areas. Larger-sized agribusinesses usually have a greater influence upon the banker, have more collateral to offer, are more profitable and more diversified, which usually guarantee them at least the first opportunity to obtain scarce funds.

Figure 5 Supply (from Commercial Banks) and Estimated Demand for Working Capital to Private Agribusinesses, 1990-91



5.4.4 Financing of Agriculture and Agribusiness

None of the institutions contacted demonstrated a negative attitude towards the financing of agribusiness. Like other private banking institutions, they tended to concentrate their loans where the risks were the lowest, namely the sugar, wheat, and cotton sectors. It was also unanimous among all bankers interviewed that the mentality of the agricultural borrower (farmer) towards credit was not healthy. They felt that in the event of a relaxation of imposed credit targets, they would substantially reduce their already small exposure in this sector. This is important to note, as bankers' attitudes are often difficult to change. Although competition can play an important role in accelerating a turnaround, there is may be a period in which agriculture is abandoned by many commercial bankers.

All of the commercial bankers indicated that they will be looking for the loans where the risk reward/relationship will be maximized. This implies that bankers will be driven by profit, which will be modified by a desire to diversify the portfolio to reduce overall risk. The sectors which are relatively stable and healthy will receive the most attention. These will include the traditional agro-industries which they have been financing. The overall implication is that to attract funds from the system, other agribusinesses will have to show signs of stability and profitability. Less government intervention, market-based prices, and improvements in technology and marketing would foster this profitability. At the same time, training programs for bankers who might specialize in financing high-risk or perishable-product agribusinesses would also be very useful.

Leasing companies were the most negative towards the farming sector, saying that their attitude towards credit was not acceptable to them. As a result, they would not consider leasing to agricultural enterprises, but may consider leasing to a company that would do this if strong collateral were provided.

Among the financial institutions dealing with agribusinesses, a void is definitely present at the level of the small and medium-sized businesses. The larger end of the spectrum is financed through institutions like NDFC, IFC, PICIC, investment banks, and the KSE. ADBP will be pulling away from agribusiness and focussing on cottage-type industries, as it regroups and cleans house. The commercial banks will not consider financing new projects where a great deal of market and technical evaluation is required. Thus room exists for a specialized institution to serve this gray zone between ADBP and NDFC and be able to play the role of market leader. To avoid political pressure, this institution should be in the private sector and driven by profit.

5.4.5 Financial Stability and Quality Control

The GOP has made it a policy to divest itself of a significant number of state-owned enterprises, including a number of agribusiness operations and a number of nationalized commercial banks. It has taken steps to increase competition in the financial sector by allowing the entry of new institutions, including investment banks, leasing companies, and private commercial banks. This raises the issue of control and stability, which is integral to the efficient performance of the banking sector as a financial intermediary. A stable financial sector ensures that the increased demands from all sectors, not only agribusinesses, can be met. The stability issue is addressed here both through an evaluation of the SBP's performance during some recent bank failures and through a synthesis of the reactions of banks that have been the subject of SBP control in the past.

In the past, many studies hinted that the default rate was very high, especially for the directed credit programs. Moreover, banks are not required to declare their provisions for bad loans in their published annual reports, which leaves one doubting the quality of the portfolios in the system. This was exactly the situation which forced both nationalization and privatization. The situation is secure as long as the SBP/GOP backs the depositors; however, the cost will be high.

When the capital of the banks is examined in relation to the assets under management, the capital/assets[137] ratio (Rs 24.3 billion capital and Rs. 704.4 billion as of March, 1992) is only 4.29%. This is quite weak when taking into account that the latest Basle accord on bank capital is set at 8% for international financial institutions. (The lower the capital levels of a financial institution, the less able it is to absorb writeoffs resulting from nonperforming loans.) Add to this the high percentage of non-performing loans (35+%),[138] and the SBP will have to be the final recourse for providing funds in the event of a failure.

One very positive sign is the publication of prudential lending regulations in the SBP bulletin of February, 1992. These regulations outline capital requirements, maximum lending requirements and limits on ownerships, which if enforced will protect the public at large from more devious large corporate interests. In addition, in 1991, the SBP moved towards the regulation of non-bank financial institutions. The question of safety and regulation was addressed by the SBP after the failure of a few *modarabas*, resulting in an amendment to the Banking Companies Ordinance, which brought the leasing companies, *modarabas*, housing finance companies, investment banks, and DFIs under the control of the SBP. In addition the SBP began the formation of a national credit bureau where information can be obtained on borrowers on a quarterly basis. All of the foregoing are indicative of an agency which is taking appropriate action and has to be interpreted as positive towards the issue of quality control.

5.5 Recommendations

5.5.1 Impact of Directed Credit on Recommendations

The policy environment in Pakistan will condition the effectiveness of any recommendations made in this study. This environment is always changing, but at present it is changing more rapidly and in more fundamental ways than in an average year. These changes will affect the prospects for agribusiness in Pakistan strongly and directly. In the financial sector, the most important general policy affecting agribusiness is directed credit.

If directed credit continues, then the situation will remain much as it has in the past. If it is removed, then the market will determine, according to the risk/reward relationship, where funds will be placed. If genuine demand by good risk borrowers outstrips supply, then the cost of funds will increase, as banks and GOP compete with each other for deposits. As the cost

[137] Capital of a bank is the same as for any company, namely the equity that the owners of the bank have injected, however, the assets of a bank are its loans and investments that they make with depositors money (banks liabilities).

[138] Personal communication.

goes up, fewer projects will be deemed good credit risks, which will slow down the increase in interest rates. The informal sector and investors on the KSE may also accept these increasing deposit rates as better values than their current investments and begin to deposit money in the banking system. This will also help to slow the rate of increase in interest rates.

Solid agribusinesses will continue to get working capital, and new ventures will continue to have difficulty in finding capital, which is normal. However, if over time efforts at reducing the constraints in those sectors where Pakistan has a competitive advantage are successful and a competitive banking environment evolves, other agribusinesses will become acceptable risks to the banking sector and will find working capital. Starting a program to inject credit specifically for agribusinesses will only end up in the same situation as we are today, with gross misuse of the directed credit programs. As the Price Waterhouse study points out,

> ... the greatest problem in the system is [a lack of] competition and until the system is privatized, banks are unlikely to accept the higher risk associated with cash-flow based lending and will continue to rely upon collateral and political connections.[139]

5.5.2 Identify Constraints

The AgriBusiness Cell of MINFAC should continue to coordinate efforts to identify the constraints that are limiting growth in agribusiness sectors where Pakistan has a competitive advantage and to outline ways in which these constraints can be addressed. Constraints that increase the risk to bankers will continue to be the limiting factor in their involvement in the sector.

5.5.3 Identify Effective Means of Promotion

The AgriBusiness Cell should promote a debate or have a study prepared on what constitutes an effective subsidy to agriculture or agribusiness in Pakistan. This would be helpful to assist the Government in revamping their ad hoc system of intervention. Resulting policies would guide the private sector to recognize opportunities for investment.

In general, the Government should provide incentives at the end of the production process or chain, as close as possible to the goal that they want to achieve, e.g., increased exports.[140] Subsidizing the production process through credit schemes and markup-free credit is not effective and unnecessarily complicates the task of all the economic actors in the chain, including bankers.

---

[139] Capital Market Study, 1990.

[140] While a direct subsidy on exports might attract retaliatory action by an importing country, an indirect subsidy, e.g., on transportation or export credit, that gains Pakistan a modest international market share is not likely to.

5.5.4 Working Capital from DFIs

The Government should instruct DFIs not to remove working capital from loan applications. Legitimate working capital requirements can and should be financed by these agencies. However, the process should contain safeguards, including detailed project analysis by knowledgeable analysts to ensure that this working capital is required. DFIs should not disburse their funds until a total financing package has been arranged.

5.5.5 Speculation

The GOP should find alternate ways to control speculation in what it considers primary food crops, mostly through the use of free and open markets. Currently the GOP tries to control speculation in wheat and sugar by limiting the amount of working capital that a bank can advance to an agribusiness. This hampers the ability of the entrepreneur to make efficient business decisions. It not only affects speculators, but also forces the true entrepreneur to make alternative arrangements for working capital, at a higher cost. Consumers ultimately bear this cost. Moreover, the fewer the factors that a banker has to accommodate in the process of risk analysis, the quicker the entry of commercial bankers into a sector. A banker should not have to deal with the additional risk that the Government may intervene in the price structure of a commodity, thereby affecting its value as collateral. The Government should limit its intervention in price setting (especially if the resulting price is unprofitable for the client) and stop determining how much banks can lend on each commodity.

5.5.6 Project Development Facilities

There is a need for more and better institutions that can undertake detailed, credible, agribusiness project analysis and market the project to institutions for investment funds, especially in the small and medium-sized project area. The smallest firms theoretically will have the ADBP, and larger ones, the banks, investment banks, and NDFC to assist them in determining project viability.

The ABC should identify the training and financial needs of existing firms. With the assistance of a donor organization, it should develop a program to meet these needs. In the beginning the institutions may require some backup technical assistance, additional funds, and substantial training to assist in the preparation of projects for submission to bankers.

The types of training required would be in the areas of marketing and technical analysis, financial and cash-flow analysis, use of appropriate technology, and project monitoring and control. Some of these programs are available through various banking institutes (e.g., Agricultural Credit Analysis through the American Bankers Association); universities (Agribusiness Project Analysis through Kansas State University, Agro-Industrial Project Management through Santa Clara University); and donor organizations. UNDP has an excellent in-country course that teaches the use of their computerized project analysis program. Bankers could eventually be included in this training program in an effort to build their confidence in the sector. This may be especially timely in light of the number of new institutions on the market and their search for new opportunities.

The Government should also consider supporting existing project development facilities or setting up new ones. The ABC should canvass the eligible bodies and determine their level of interest. Ideally, the institution would be able to foot some of the cost, operate on a minimum level of subsidy, and have a vested interest in the work. LUMS and chambers of commerce are ideal candidates. They have the necessary facilities, the ties to the agribusiness community, and an interest in the outcome. A donor could provide technical assistance to develop the necessary analytical capability.

In the beginning business will be hard to obtain, and financial independence will not be assured, but it should be a goal. Becoming financially independent is important if the institution is to remain viable in the private sector and maintain a realistic approach to project proposal preparation.

5.5.7 Private Sector DFI

With the formal banking sector becoming more developed, there is a need for an institution that can lead the way for the agribusiness sector. Many institutions have agribusiness as a portion of their portfolios, but none specializes in the sector. There is little service to the small and medium-sized agribusiness.

MINFAC should survey the private sector to find a leader who can "get the ball rolling." Once this individual is identified, MINFAC should assist him/her in raising the funds to finance a prefeasibility study focusing on the following issues:

- Size of the potential market for this institution
- Examples of projects that could be financed
- Types of services and loan products that are required by this market
- Level of private investor interest (in rupees) in a private DFI
- Level of international donor interest (in rupees and/or foreign exchange)
- Legal obstacles and sanctions that have to obtained or created
- Legal form of institution that will be set up
- Steps that should be taken to achieve realization

Once a prefeasibility study has been prepared, it can be circulated among interested parties. Conditional letters of commitment should be obtained from:

- The regulatory bodies concerning legislation that may have to be prepared and special licenses to be given
- International donors regarding their level of assistance and loans
- Private investors regarding their level of equity.

Once the legal framework has been set up, the company can be formed and begin the process of preparing the institution. One of the donors should provide a technical assistance package. The package would include the services of a first-class consulting operation, which would develop the rules and regulations, manuals of operation, and accounting system of the institution. This should be done along with the executive officers of the institution (Managing Director, Manager of Credit, Administration Manager).

Once the procedures have been prepared and the staff hired, marketing can begin. The institution can start by surveying some of the agribusinesses that the prefeasibility study team visited. At the same time it can compile an extensive list of agribusinesses to keep as its marketing list.

This DFI, with officers experienced in the analysis of agribusiness projects, could offer a complete package to small and medium-sized agribusiness firms, and at the same time promote understanding of the sector among banks. In essence it would be a market leader. To do so, a high degree of professionalism would be required. To succeed it must be insulated from political intervention.

A private DFI is a difficult balancing act (profit vs. development) and as a result does not escape criticism. Around the world, however, there are quite a few successful, private DFIs that lend at market rates. Their strengths and contributions to development include the following: they cover much of the risk before the project starts through a thorough analysis of the project; they have the monitoring capacity to provide follow-up; and they are motivated by profit. Private DFIs are profitable, have a much higher rate of payback than national development banks, and a greater share of their projects are viable.

A private DFI should be free of Government regulation regarding the levels of debt-equity ratios. The DFI should determine these in relation to different industries, regions, and creditors. For example, a loan in the sugar sector in Punjab may have different terms than one in the Sind because the long-term prospects of the industries in those provinces may be different.

None of the foregoing suggestions if implemented will alone solve the problem of a shortage of working capital in agribusiness. All of them together, however, could go a long way toward creating a level playing field, on which investors could make informed choices about where to invest their funds.

5.5.8 Investment Guidelines and Procedures

To attract highly favorable debt-equity ratios (up to 80:20), Pakistani entrepreneurs are required to register new companies. Such financing is not forthcoming for investment within existing companies. Chapter 2 shows the fragmentation and its disadvantages that such a bias leads to. There should be no such general difference in the investment procedures or incentives for old and new companies. Differences in loan terms should be based on risks and potential profitability. Since in at least some cases an existing company will present a lower risk for the same reward, there should be no general discrimination against existing companies.

5.5.9 Credit Bureau

Work on the implementation of a national credit bureau should continue as planned. This type of common knowledge assists bankers in their assessment of risk and averts difficulties with borrowers, especially the type that tend not to disclose all of their borrowing. It is especially important that all financial institutions participate; otherwise the effectiveness of the system will be limited. A credit bureau will help all sectors of the economy, not only agribusiness.

5.5.10 Industrial Cost Statistics

Industrial cost statistics were used above to estimate the demand for working capital. However, the latest statistics available are for 1986-87, seriously out of date, especially with all the changes in the banking system underway. The Government should improve the timeliness of these data. They would be particularly useful to bankers as guidelines for the working capital needs in different industries, including agribusiness.

5.5.11 Research on Financial Intermediation by Agribusinesses

An important research need is to determine the extent to which different agribusinesses are undertaking financial intermediation, namely lending to farmers. This will point to specific financial needs among both agribusinesses and producers.

6. PAKISTAN'S CHANGING TAX STRUCTURE AND INVESTMENT PROMOTION POLICIES: IMPACT ON AGRIBUSINESS

6.1 Introduction

This chapter briefly reviews the investment incentive structure in Pakistan with a view to determining whether the treatment of agribusiness is comparable to that of other industries. In addition the chapter examines whether or not the current policy environment contains counterproductive incentives and whether or not the incentives are cohesive, reflecting a sound development strategy for agribusiness.

First, the major sectoral policies in Pakistan are reviewed. Then incentives to invest in agribusiness are analyzed, with a focus on tax incentives. Tax incentives issues are highlighted and recommendations are presented.

In general, it does not appear that agribusiness is at a disadvantage with respect to other industries. On the other hand, the existing incentives do not reflect a cohesive long-term, goal-oriented strategy. Incentives often pertain to very specific sectors or industries, apparently the result of lobbying rather than a well-developed strategy.

6.2 Major Sectoral Policies

There are many factors which stimulate business investment, including the availability of investable resources; the potential for return on investment; availability of raw materials; marketing, management and technical expertise; services and infrastructure; and government incentives and subsidies. For the development of a particular economic area, all of these factors, with the exception of the last, must be present. Conversely, the lack of one or more of these could easily hamper development. Thus it is probably easier for government (dis)incentives alone to hamper the development of a particular economic activity than to stimulate it.

6.2.1 National Agricultural Policy

The Government of Pakistan has promulgated various incentive schemes that are relevant to agribusiness, although most are not specific to agribusiness. The National Agricultural of Policy (NAP). The policy recommended that the GOP carry out the following:

- Develop a national agribusiness policy
- Provide incentives for private sector investment
- Establish agribusiness industrial estates in rural areas
- Provide infrastructure in the rural areas to support agro-based industries.

6.2.2 Industrial Policy

Under the Industrial Policy of 1991-92, no specific incentives have been offered for agribusiness; however, the following incentives have been offered to new investors in key industries, which include fertilizer:

- A 4-year tax holiday throughout Pakistan
- Equipment for industries is exempt from payment of custom duties, provided that such equipment is not manufactured in Pakistan.

In addition

- Export earnings from textile garments, leather garments, engineering goods are eligible for 75% income tax rebate.

6.2.3 Rural Industrial Scheme

Under the Rural Industrial Scheme, the following incentives to investment would apply to agribusinesses and other industries set up in rural areas:

- Financial assistance at a mark-up of 8% per year with a maximum grace period of one year
- A 5-year income tax holiday
- No questions about the source of capital
- Importation of equipment exempt from custom duties, sales tax, and license fees.

6.2.4 Incentives for Export-Oriented Industries

Industrial units exporting more than 70% of their output have been designated export processing units (EPUs), and are eligible for the following:

- Exemption of tax to the extent of 75% on the income earned from exports for apparel and made-up garments, leather products, surgical instruments, engineering goods, and furniture
- All export-oriented industries are exempt from customs duties, sales tax, *iqra*, surcharge, and import license fees on the import of equipment, spare parts, and raw materials
- Import duties and sales tax are waived for the import of machinery for the following industries: weaving, dyeing, finishing and processing of fabrics, knitted or crocheted textiles, made-up textiles, leather garments/gloves, equipment for grading, packaging and processing of fruits and vegetables, and refrigerated vehicles for perishable products.

6.2.5 The New Special Industrial Zone Policy

The Government has announced a new policy in their 1992-93 budget through which it will set up new industrial zones with complete infrastructure. These industrial zones will enjoy the following concessions:

- 5-year tax holiday
- Exemption of customs duty and import surcharge on equipment not manufactured locally
- Reduced rate of import license fee of 2%
- Foreign investors bring their own foreign exchange
- National financial institutions can provide local loans according to their rules and regulations
- No restriction on borrowing and repayments and on the payment of royalty and technical fees

These concessions are subject to the following conditions:

- At least 60% of the production is exported
- At least 40% foreign investment.

6.2.6 Foreign Investment Policy

The government has opened virtually all industrial fields to foreign investors. The negative list for foreigners includes forestry, ownership of agricultural land, irrigation, real estate, insurance, and health. However, livestock farming, seed farming, dairy farming, feed, canning and preservation of fruits, chemical fertilizers, sugar byproducts, and textile weaving are on the indicative list of foreign investment priority areas, including leasing of agricultural land.

6.2.7 Non-Repatriable Investment Scheme

Investments by overseas Pakistanis are being encouraged by providing incentives under the Non-Repatriable Investment Scheme (NRIS), under which customs duty concessions are available. The scope of this scheme is being enlarged to include agriculture, horticulture, fisheries, and livestock. Goods like combine harvesters, agricultural tractors, and implements used for tilling, planting, and harvesting are also covered under this scheme.

6.3 Tax Incentives to Invest in Agribusiness

Pakistan's tax system is based on the Government of India Act 1935 which is governed by the provisions of the Income Tax Ordinance of 1979, the Wealth Tax Act of 1963, Sales Tax Act of 1990 and as amended by the Finance Bill of 1991. The tax system is administrated by the Central Board of Revenue and is updated every year in June.

The fundamental directive of the Finance Act, 1991 was to broaden the tax base and to simplify the tax system by removing the legal and administrative pitfalls which would help voluntary payment of taxes specially the direct taxes. These objectives are the basis of any tax reforms. The new concepts that were introduced in this bill are:

- A system of "presumptive tax" for certain classes of tax payers, incomes or payments
- A fixed tax system for those small business enterprises where maintaining and rendering of accounts has historically been a problem
- A recognition that every sector should pay a certain minimum to the national exchequer, such as the corporate sector is now required to pay a certain minimum tax even if there is no liability to pay any taxes
- An identification of unearned income or payments.

Presently, all companies incorporated in Pakistan are assessed for tax the rate of 30%, plus a supertax of 30% in the case of a banking company, 15% on a public company other than a bank, and 20% on any other company. There is also a surcharge. A base tax of 0.5% of the turnover is payable by all corporations. Under the latest budget proposals, in the next five years, the tax, supertax, and surcharge would be combined and gradually reduced from a total of 64 to 55 percent on banking companies, 42 to 30 percent on public companies, and 52 to 40 percent on other companies.

Table 9 Some Common Investment Incentives

Financial Concessions

- Income and Excise Tax Deductions, Exemptions, or Holidays
- Import or Export Levy Exemptions, Reductions, or Rebates
- Credit Subsidies and Guarantees

Special Rights

- Raw Material Imports
- Product Exports
- Repatriation of Profit and/or Capital
- Access to Foreign Exchange
- Regulatory Exemptions (*e.g.*, from labor or environmental laws)
- Access to Specialized Infrastructure (*e.g.*, cold storage)

Investment incentives generally take one of two forms: financial concessions or special rights.[141] The most common investment incentives are shown in Table 9. In addition, support services provided by a government can also be instrumental in bringing about investment. Some of these services are trade fairs, market information services, and buyer identification services. (Support services provided by the AgriBusiness Cell are described in section 3.3.) Thus tax incentives are only one area in which agribusiness might have an advantage or disadvantage vis-a-vis other sectors.

[141] The distinction is not meant to imply that special rights do not result in financial gain or loss. A good analogy for the distinction, and one example, is the difference between tariffs and quotas.

6.3.1 The Incentive Structure in Pakistan

A non-exhaustive list of these incentives in Pakistan is shown in Annex Table 2. From this table one can see that, at any given time, there is a maze of levies, exemptions from those levies, regulations, exemptions from those regulations, and various other incentives and restrictions that apply to both agribusiness and other economic sectors in Pakistan. Moreover, these incentives change frequently. Examples of the anomalies that can arise are given in a letter from the Pakistan Poultry Association to the Minister of Agriculture.[142] These include:

- Agriculture is exempt from income tax, but poultry and livestock are not (except for new poultry enterprises)
- Entrepreneurs setting up new machines in existing buildings receive an income tax exemption, whereas entrepreneurs setting up poultry operations in an existing building do not
- Poultry feed ingredients are duty-free when imported by the pharmaceutical industry, but not by the poultry feed industry
- Pakistan Railways provides a rebate of 50 percent in its tariff for perishable commodities including fruits and vegetables, but not including chicken and eggs

Until this patchwork is simplified and made more stable, a prospective agribusiness entrepreneur would have to devote considerable resources to finding out about and taking account of these incentives and regulations in developing a business plan and in operating the business.

The remainder of this chapter focuses only on tax incentives. "Tax incentives" are defined for the purpose of this chapter to be reductions of direct (income) taxes that are given selectively or indirectly to agribusiness. Major trade-based and excise (indirect) taxes will also be mentioned in the discussion below when they are prominent features of the policy environment.

6.3.2 Agribusiness vis-a-vis Other Sectors

In general, agribusinesses in Pakistan are subject to the same corporate taxes and eligible for the same incentives as other industries under various incentive schemes. Thus, any export-oriented agribusiness (i.e., one exporting more than 70 percent of its production) is eligible for the exemption from customs duty, sales tax, *iqra*, surcharge and import license fee on the import of equipment, spare parts, and raw materials. Any agribusiness that sets up in a new industrial zone is eligible for the 5-year tax holiday. Moreover, under the NRIS, agriculture-based enterprises are eligible for the customs duty concessions.

In addition, fertilizer is a key industry, so those setting up fertilizer plants receive a 4-year tax holiday and other concessions. Poultry and fish farming are also singled out for a 5-

[142] Letter from Khalil Sattar, Chairman, Pakistan Poultry Association, Karachi to the honorable Minister for Food, Agriculture, and Cooperatives Lt. Gen (Retd) Abdul Majid Malik, dated April 27, 1992.

year tax holiday. Income from agriculture per se is not taxable. Thus an agribusiness with an integrated operation that included production would have a lower average tax burden than a non-integrated business.

Investments in rural and lagging areas receive the most generous concessions. These include tax holidays, an investment tax credit, and exemption from tax on dividends for ten years. Agribusinesses may be more amenable than other businesses to locating in these areas, since being near the source of a perishable supply may be important.

Sales tax is chargeable at a rate of 12.5% on the sales price of goods manufactured. The following agribusiness products are exempt from this tax: seeds, seed oil, textile products, agricultural machinery, matches, leather goods, dairy products, live animals, vegetables, fruits, cereals, edible oils, and fertilizers.

Central excise duties are leviable on goods manufactured and produced and on services provided in Pakistan. Today, 74 goods and 13 services constitute the tariff. 35 items are however totally exempt from tax. Agricultural products like sugar (17% of total excise tax), tobacco and cigarettes (37%), beverages (3%), cotton yarn (4%) are major tax contributors.

6.3.3 Tax Incentive Issues

Many incentives offered by the Government are towards new (agri)business: the same benefits are not offered to existing businesses. Some incentives promote BMR, so they would cover new investment by an existing firm. Thus some incentives guide investors into setting up new companies, while others attempt to make existing companies more efficient. If the same management sets up new companies, the result may be inefficient management (see Chapter 2). Clearly the cost of all these regulations is large. Entrepreneurs must take account of them when they plan or operate a business. Government must spend precious resources keeping track of and administering them.

Another serious problem with investment incentives that are tax-based is that they are ineffective in an environment in which most companies pay very little in taxes. In Pakistan, only 11 percent of the Government's total revenue comes from income tax.[143] (See Annex Table 3 for shares in other countries.) If a company does not pay much in taxes, what value is it to be exempt from them? Why should an entrepreneur go to the effort of setting up a new company to take advantage of tax incentives when s/he would have little tax liability anyway? Conversely, tax incentives will be availed by those who already decided to invest; the incentive relieves them of the need to evade taxes. If incentive programs are extended, some companies are likely to shut down and transfer their capital to new companies to avail themselves of the new program. Thus in Pakistan, tax incentives are likely to cause very little <u>new</u> investment that would not have occurred anyway.

---

[143] 1990-91, calculated from Economic Survey, 1990-91, Statistical Supplement, p. 137.

Tax incentives are more relevant for potential foreign investors, since their accounts are usually more accessible, and they are more likely to be paying taxes or to anticipate paying taxes on a foreign operation. Thus without any restructuring, the tax incentive system currently in place would be more effective (barring other constraints) in attracting foreign than domestic investment. Put another way, this means that the Government need not set up a separate incentive structure for domestic and foreign companies. Whatever rational system is offered will be availed of by those for whom it is attractive.

Incentives to invest in rural and backward areas probably promote agribusiness more than other sectors, but to some extent these incentives only compensate for a lack of infrastructure. The biggest attraction for potential investors in rural areas is the 80:20 debt-equity ratio. See section 5.4.2 for a discussion of the problems associated with high debt-equity ratios.

6.4 Recommendations

This chapter is an analysis of the tax incentives received by agribusiness *vis-a-vis* other sectors. The analysis has implications both for the tax code itself and also in related areas.

6.4.1 Recommendations Regarding Taxation

The Government would do well to maintain and, where possible, redouble its efforts to broaden the tax base. This will result in a tax system that is perceived to be more fair, which will in turn lead to better compliance. Better enforcement of the tax laws would of course also have this effect. As compliance improves, the effect of tax incentives as a stimulant to investment in agribusiness will be enhanced. At that time, should special incentives be desirable, they could be effective.

The system of direct and indirect tax incentives should be streamlined. Compliance is too costly in terms of time spent by both businesses and the Government. The market should decide where to allocate resources, not the Government through a maze of duties and exemptions. More poultry farms may look like a good idea this year, but how does the Government know when to stop promoting them? The example of UHT milk plants is instructive. The system should also be stabilized. Investors will not take risks by sinking their funds into a particular business area in a particular location if they feel that soon afterwards the Government will give an advantage to another area or location.

If it is determined by the Government that agribusiness is going to play a key role in employment and income generation (and this is certainly possible), then "agribusiness" needs to be clearly defined. The broadest possible definition and incentives structured to be widely applicable will keep down both the cost of administration and economic distortions. Integrated agribusiness operations may include direct agricultural production. Thus a distinction between agriculture and agribusiness is probably counterproductive. Well-established industries like textiles do not in general need more incentives.

Another area where complete coverage would increase the perception of fairness is the exemption of income from agriculture from direct taxation. A way to begin to treat agriculture on an equal basis is to introduce a system of cash accounting. In Canada, this was adopted for farmers and fishermen for several reasons. First, they were not familiar with sophisticated accounting systems, and the cash basis is much easier. In addition, the fluctuating price of their inventory and the vagaries of weather cause their incomes to vary greatly from one year to the next. This system worked well in acquainting farmers with a simple accounting system. In Pakistan, it could help bring farmers to the point of understanding their accounts and preparing them for the time when they would be paying taxes.

6.4.2 Related Recommendations

The Government will have to work hard to attract foreign investment.[144] Once 2 or 3 important firms invest and remain in Pakistan, others will take that as a sign that it is possible to function and profit in Pakistan. The issue is the combined attractiveness of tax and other incentives as well as the on-the-ground reality of doing business, which includes either getting help from and/or not being hampered by the Government.

Improvements in rural infrastructure and training would eventually make incentives to locate in rural areas unnecessary. In the long run, roads, markets, education, and other "permanent" investments are better than regular concessions. Permanent investments continue to generate employment and income as long as they are maintained. Concessions cost the Government money for each company that takes advantage of the incentive. If that company goes out of business after making use of the concession, the Government has little to show for the cost incurred.

---

[144] A prominent American businessman in Pakistan said recently: "...the Government has made it easier to set up a business, [but] running it on a day-to-day basis is as tough, if not tougher, than before." Robert McCusker, former president, American Business Council, currently President, Interpak Shaving Products (subsidiary of The Gillette Company), quoted in "Key word: quality," *The International News*, July 11, 1992.

7. SUCCESSFUL AGRIBUSINESS-ORIENTED POLICY ACTIONS IN OTHER COUNTRIES

Lessons learned from other countries may offer ideas to policymakers in Pakistan responsible for formulating actions to promote the growth and development of the country's agribusiness sector. This chapter begins with a brief summary of some of the key factors that contribute to successful agribusiness development. A comparison of Pakistan's investment and tax incentives for agribusiness with eight Asian and Near Eastern/North African countries follows. The chapter concludes with two case studies of successful agribusiness development that examine the evolution of the horticulture sectors in Chile and Thailand.

7.1 Key Factors For Successful Agribusiness Development

A review of the literature suggests that there are certain key factors that contribute to the growth and development of a successful agribusiness sector. These factors include:

- Comparative advantage
- Availability of basic infrastructure
- Participation of the private sector
- Favorable investment climate

These are the factors that must be present to take advantage of a clear market opportunity.

7.1.1 Comparative Advantage

The first criterion for a country to be successful in a particular agribusiness activity is to have a comparative advantage in producing that particular product. This comparative advantage is determined by various factors including agro-climatic conditions, technology, labor cost and productivity, and shipping costs. However, technology can change drastically. One example of such a change was the production of pineapples in the Dominican Republic. The local variety was not suitable for export, and the country had no comparative advantage in producing this fruit. After it was able was able to lease land from the Government, a foreign company flew in seedlings from Hawaii. As a result of this introduction of a proven variety of export-quality pineapple, the country became competitive instantly. Thus, comparative advantage is not static; it can change. Using the selected countries as examples, Chile has developed a comparative advantage in producing grapes, and Thailand, in mangoes.

7.1.2 Availability of Basic Infrastructure

Basic infrastructure is another important factor for agribusiness development. A country's comparative advantage in producing a crop can be diminished if the infrastructure needed to move, store and process the crop between the farmgate and consumer is not adequate. Agro-industrial development requires adequate roads to transport inputs and final products, refrigerated facilities to store fresh produce, market information, phyto-sanitary laboratories, and grades and standards. Public investments in these areas of basic infrastructure can help create an environment that will promote private sector investment in agribusiness. As the Chile case detailed later in this chapter will show, a clearly defined role for the Government as a facilitator and provider of basic infrastructure can help promote the development of a private sector that produces and markets products profitably in competitive markets.

7.1.3 Participation of the Private Sector

Private sector operators usually knows what is needed to attract investment. In particular, there is a growing body of evidence to suggest that entrepreneurs are unwilling to investment in agribusiness activities if it means competing directly with a state-owned enterprise, especially one that benefits from special privileges. The participation of the private sector can also be very constructive in determining ways to eliminate the constraints to agribusiness development in a country. Therefore, the participation of the private sector in policy dialogues is another important factor that can contribute to agribusiness development.

7.1.4 Favorable Investment Climate

A country's overall investment climate must be favorable to attract the capital needed to spur agribusiness development. Stability is a key issue here. Investors in general need to have confidence that the policy regime is stable and will not change precipitously. Changes require a transition period so that the private sector can adapt to the new environment. Some of the key indicators of a favorable investment climate include open market policies, the elimination of distortions in the economy, fiscal policies that limit government deficits to manageable levels, a market determined exchange rate, and unification of import tariffs.

Investment and tax incentives that are widely available can help promote entrepreneurial activity in agribusiness. As examined in more detail in the next section of this chapter, these might include tax holidays, investment tax allowances, industrial adjustment allowances, reinvestment allowances, export allowances, and customs duties exemptions for inputs. In some cases, policies serve to enhance the investment climate for agribusiness by providing industry specific incentives which serve to make agribusiness more attractive relative to other sectors of the economy. This is the case, for example, in Malaysia where agribusiness became a priority sector under the Promotion of Investment Act of 1986. Agro-industry and agriculture benefit from a number of incentives under the act.

Pioneer Status. Agribusinesses participating in a promoted activity or producing a promoted product, expending at least M$25 million (US$9.23 million), and employing at least 500 full-time Malaysian employees by the end of the tax period, are eligible for pioneer status. This entitles them to a 5-year tax holiday, extendable to 10 years by the Minister of Trade and

Industry. Firms benefiting from pioneer status can distribute profits to shareholders as tax-exempt dividends.

Investment Tax Allowances. Agribusinesses participating in a promoted activity or producing a promoted product may deduct up to 100 percent of capital expenditure incurred during the first five years. For integrated agricultural activities, this period can be extended to ten years. Agricultural projects are eligible for higher tax allowance rates than manufacturing and most tourism projects. Agribusinesses that export 50 percent of their product or produce a product imported in large quantities can deduct 50 percent of investment taxes. Agribusinesses involved in integrated agricultural production with both cultivation and manufacturing components can deduct 100 percent of their investment taxes.

Long Term Leases. In addition, agribusinesses are attracted by the 99-year leases that are easily obtainable on agricultural lands, and the possibility of property ownership.

In general, policies to promote agribusiness investment will be most successful when they build upon a country's comparative advantages, and the basic infrastructure is in place for firms to operate competitively. Under these conditions the private sector will respond to opportunities.

7.2 Tax and Investment Incentives: A Comparison

Pakistan's policies to promote agribusiness development through tax and investment incentives do not vary demonstrably from those countries against which it is likely to compete for foreign investment in agribusiness. Annex Table 3 provides a summary economic profile, overview of the investment climate, synthesis of the policies governing the repatriation of capital and foreign ownership, and a comparison of the investment, tax and non-tax incentives for agribusiness investment in nine countries, including Pakistan. The table includes data for comparison from eight Asian and North African countries, including Egypt, India, Indonesia, Malaysia, Morocco, the Philippines, Thailand and Tunisia. Malaysia has been expanding its production of aquaculture, fruits, poultry and food processing. Morocco has been successful in the production of citrus, fruits, grapes, dates, peaches, cherries, strawberries, tomato paste, condiments and vegetables. The Philippines has had success in prawn production and foreign investments have traditionally produced pineapple and bananas. Thailand has been successful in attracting joint ventures to develop its agro-industry. Tunisia has been most successful in olive oil, frozen fish, tomato paste and harissa (hot sauce).

After providing a brief economic profile of these countries, this section compares the key features of Pakistan's investment and tax incentives for agribusiness with those of the rest of the group.

7.2.1 Economic Profile

The first section of Annex Table 3 provides a summary economic profile of the nine countries. The World Bank classifies countries according to GNP per capita, and uses this criterion to rank countries to provide basic indicators in its World Development Report.[145] The first section shows that the countries being compared to Pakistan are broadly similar, particularly in individual attributes. In order to provide some perspective on the overall economic profile of the countries whose investment and tax incentives are the subject of this chapter's comparison, Table 11 reports GNP per capita (GNP/cap.) in U.S. dollars ($) and agriculture as a percentage of Gross Domestic Product (Ag./GDP). Generally speaking, there is an inverse correlation between a country's per capita income and the overall importance of agriculture to the economy. That is, the normal course of development is for primary agriculture to decline as a share of GDP and other sectors, including agribusiness, to increase.

Table 10 Economic Profile of Selected Countries

Country	GNP/cap. ($)	Ag./GDP
Malaysia	2,373	18.6%
Tunisia	1,549	17.0%
Thailand	1,042	11.9%
Morocco	916	17.7%
Philippines	717	27.0%
Egypt	646	19.7%
Indonesia	587	23.4%
Pakistan	370	25.6%
India	240	33.8%

7.2.2 Investment Climate

The second section of Annex Table 3 provides a general summary of each country's overall investment climate. According to the credit-worthiness rankings of *Institutional Investor* magazine, Thailand had the highest rank of the group, 25th overall, followed closely by Malaysia (26th), Indonesia (33rd), Tunisia (46th), India (48th), Morocco (57th), Pakistan (62nd), Philippines (67th), and Egypt (71st). Other measures of the overall investment climate included in Annex Table 3 include foreign direct investment, government's attitude towards foreign investment, labor's attitude towards foreign investment, intellectual property rights and comparative labor costs. Although foreign direct investment in Pakistan pales in comparison to the Asian countries for which data are available, on the other criteria the country compares favorably with the competition.

[145] World Bank, 1992.

7.2.3 Repatriation of Capital and Foreign Ownership

The policies that guide foreign ownership and the ability of foreign investors to repatriate their capital are key factors in a country's ability to attract foreign investment. Foreign investors can play an important role in developing the agribusiness sector in a country. They can provide access to markets and new technology for crop production, processing and marketing. Generally speaking, the fewer the restrictions the more attractive a country is to outside investors.

The third section of Annex Table 3 looks at several key criteria in this regard including foreign ownership of companies, foreign ownership of land, and the repatriation of capital, profits and dividends. All the selected countries allow repatriation of capital, profits and dividends. However the degree of flexibility and restrictions vary by country. Pakistan and the Philippines guarantee the repatriation of profits and dividends, and while Philippines also guarantees the repatriation of capital, Pakistan only guarantees the repatriation of up to the amount of original investment. On the other extreme, Thailand only guarantees repatriation of capital if the enterprise is terminated. The other countries are not as strict as Thailand, but they have certain restrictions in repatriation policies.

Pakistan, Tunisia and the Philippines prohibit foreign ownership of land, which can serve as a disincentive to foreign agribusiness investors. In Morocco, foreigners cannot own agricultural land, and in Malaysia it is permitted, but not encouraged. Malaysia and Morocco have 99-year leases for agricultural land, while in the Philippines, there is no limit. Tunisia leases up to 40 years if the majority is owned by Tunisians.

7.2.4 Investment Incentives

The specific incentives the countries included in this comparison offer to the potential investor in agribusiness are limited. Each country has incentives for designated priority sectors, and it is interesting to note how these priorities vary. Tunisia is the only one in the group that singles out specific areas of agriculture as priorities. There is more emphasis on industrial pursuits, with Malaysia alone designating agro-industry a priority. Other countries, including Pakistan with agro-chemicals, have targeted more narrowly defined agribusiness sectors as priorities.

Each country in the group has special incentives to promote regional development. However, the general consensus is that these special programs have little if any impact stimulating the flow of investment capital to areas that are not otherwise favorable for agribusiness investment. That is to say areas that offer some comparative advantage, provide the infrastructure agribusiness requires, and perhaps most important of all, offer ready access to the market.

7.2.5 Tax Incentives

Every country in the group provides tax breaks for certain undertakings. In some cases these are general incentives available to activities across the economic spectrum. In other cases, Pakistan and Tunisia being the best examples, policies provide specific tax breaks for agriculture and agribusiness. The length of tax holidays varies from 3 to 8 years in Thailand to 10 years in Tunisia. All the countries, except for Thailand, either do not charge taxes on inputs of exported goods, or have some kind of drawback scheme for local inputs. Regarding import duty exemptions for inputs, each country has its own rules. Tunisia has no value added tax, and the other countries have a drawback allowance for exported goods. Pakistan, Morocco and Malaysia have additional tax breaks for exporters.

It is important to note that tax breaks will only serve as effective incentives for agribusiness development when the government has the capacity to enforce the tax laws and collect taxes. If the tax laws are generally unenforceable and it is easy for businesses to evade taxes, tax breaks are not likely to provide much incentive to the potential investor. Note in this regard both that there is a strong tendency for countries with higher per capita income to obtain a higher percentage of government revenues from direct taxes, and that among the countries in Annex Table 3, Pakistan has the lowest percentage of revenues from direct (income) taxes.

7.2.6 Non-Tax Incentives

Non-tax incentives include feasibility study funds, start-up low-interest loans, equipment subsidies, training subsidies, and export credit finance. Tunisia is the only country that has a feasibility study fund and grants equipment subsidies. Pakistan, Morocco and Tunisia have start-up low-interest loans. Tunisia, Malaysia and the Philippines have some kind of training subsidy, and Pakistan, Morocco and Malaysia have export credit programs.

7.3 Successful Agribusiness Development: Case Studies

Policy reforms and incentives are not the only tools countries have to stimulate growth and development in the agribusiness sector. Chile is a good example of private-public sector cooperation and collaboration to meet development needs. Thailand offers another example. The case studies that follow provide two examples of successful agribusiness development.

7.3.1 The Dynamic Growth of Chile's Horticulture Sector

Chile's total agricultural crop production has nearly doubled since 1980. The country has been very successful in expanding its exports of fruits and vegetables, transforming its agriculture to gain access to world markets. Fresh fruit exports from Chile increased 150 percent, from $220.4 to $582.3 million between 1983 and 1988. The area planted in orchards more than tripled, increasing from 53,000 ha. in 1965/66 to 162,000 ha. in 1988/89. Growth was particularly strong in table grapes, pears, plums, apples, and apricots. Processed vegetables has been an area of rapid growth, particularly in tomato paste and dehydrated peppers.

Chile is an interesting case study because of the number of different factors that contributed to the successful development of its potential in horticulture. These factors include:

- A long tradition of public-private sector cooperation
- A dynamic private sector which had been active in the past and was prepared to invest in agriculture once the economic and political climate was right
- An appropriate political and economic climate
- Credit programs to finance long-term needs of the agribusiness sector
- A reservoir of trained professionals ready to assume managerial and technical positions
- Long-established institutions
- A basic transportation infrastructure of roads and port facilities
- Good ocean port location

Efforts to reform policies, create public sector institutions that are responsive to the needs of a market-driven private sector, build a lasting framework for public-private cooperation, improve business practices, and create trade linkages have helped the Chilean fruits and vegetable sector to flourish.

Macroeconomic policies. Success came as a result of a gradual process of government and private sector cooperation and interventions. The country went through several periods of political and economic instability until 1983, when it started to adopt sound economic policies. The first step was the adoption of a set of economic policy reforms that eliminated distortions. A most influential policy reform was a modification of the foreign exchange regime to make Chilean products more competitive in world markets. Import tariffs were also reduced increasing the competitiveness of imported commodities.[146] In addition, non-tariff barriers have been eliminated, and foreign investment regulations and procedures have been modified to provide a very open and favorable climate for foreign investment.

Chile uses a crawling peg to determine the official foreign exchange rate. Each month's peg is based on a formula that measures inflation differentials between Chile and its major trading partners in the preceding month. Parallel market and interbank rates are allowed to float freely within a band of five percent above and below a midpoint. This midpoint, called the "acuerdo" rate, is the Central Bank's reference point, and is adjusted daily to reflect the inflation differentials noted above. When the parallel and interbank rates fall bellow the band's lower limit (implying an appreciating peso), the Central Bank buys the market's excess dollars. When they exceed the band's upper limit, the bank sells dollars to maintain its rate.

---

[146] The unified import tariff was set at 15 percent ad valorem, which has been reduced to 11 percent. In addition, there is a value-added tax of 18 percent on imports.

Export procedures have been simplified for non-traditional exporters. Small non-traditional exporters also qualify for the government's simplified drawback system. Through this mechanism, the government returns to producers an amount equivalent to 10 percent of their exports' value. This figure represents an estimate of the duties actually paid for imported components in the exported merchandise. Alternatively, qualifying exporters can apply for the return of all paid duties. The government of Chile also provides exporters with quicker tax returns on the VAT than other producers receive.

In addition, exporters can defer tariff payments for capital imports. They are also allowed to ask for tariff waivers at a rate determined by the ratio of total export to total sales. If all production is exported, the exporter pays no tariff for capital imports.

Key Institutions and Their Roles. Given the number of different of public and private institutions involved in the successful development of Chile's horticulture sector, it is important to understand the focused role each has played. The box below provides a summary list of the key public and private institutions that played important roles in this success story.

Ministry of Agriculture. The Ministry of Agriculture has played a key role in formulating and implementing policies that have provided incentives for private initiative. In the late 1950s, it sponsored a study to review major fruit species and varieties, described their main characteristics, marketing seasons, and most relevant potential markets. In 1968, the Ministry and CORFO (see below) jointly published the *National Fruit Development Plan*.

The National Fruit Development Plan, developed with the active participation of the private sector, provided the baseline from which the sector developed. However, there was very little response until after 1974, when liberalization of the economy provided a climate in which growth could flourish. In the public sector, the National Planning Office established the rules governing the relationship between the public and private sectors; the Ministry of Agriculture pressed for elimination of land expropriation legislation, confirmation of private property rights in agriculture, and granting of land titles to beneficiaries of land reform; and CORFO, under a revived National Fruit Development Plan, mobilized the necessary loans and loan guarantees to finance the planting of orchards, and the construction of packing houses and cold storage facilities. In the private sector, the National Agricultural Society lobbied for a clear definition of private property rights and encouraged farmers to show confidence in the new economic environment by investing in agriculture.

Successful Agribusiness Development:
Horticulture in Chile

Key Institutions

Public Sector	**Private Sector**
Ministry of Agriculture Agriculture and Livestock Service	National Agricultural Society (SNA)
National Agriculture Research Institute (INIA)	Catholic University of Chile
National Institute for Agricultural Development (INDAP)	Exporters' Association
Chilean Development Corporation (CORFO)	The Chile Foundation
Promotion Institute for Chilean Exports (PROCHILE)	The Federation of Fruit Producers (Fedefruta)
Central Bank	
University of Chile	

The role of the Ministry of Agriculture has evolved over time. Initial emphasis was on plant health, disease and pest control. Beginning in 1975, emphasis was placed on market information: computerized facilities to access price information from important world trade centers. Later on, it funded research through INIA and FIA, allowing universities and other institutions to bid on projects.

The Agriculture and Livestock Service (SAG[147]) is a specialized agency of the Ministry of Agriculture responsible for implementing many of the policies that fostered agribusiness growth in Chile. It has evolved from a highly centralized controller of exports to an agency that monitors imports and exports to ensure that they are free of insects and disease. It signed an agreement with the U.S. Department of Agriculture (USDA) and the Food and Drug Administration (FDA) to control sanitary conditions at packing houses and cold storage plants that significantly accelerated shipments. SAG also controls imported seeds and keeps records on seed multiplication, but responsibility for seed certification was transferred to the Association of Seed Producers, a private sector entity.

The National Agriculture Research Institute (INIA) was created in 1964 as a semi-autonomous entity to continue Ministry of Agriculture and Rockefeller Foundation programs. It works through Technology Transfer Groups, created in 1982, to transmit technological research findings to almost 2,000 farmer members.

The National Institute for Agricultural Development (INDAP) is a semi-autonomous entity under the jurisdiction of the Ministry of Agriculture. INDAP operates in rural communities, providing small-scale farmers and rural artisans with scarce resources and appropriate technology. Its main objectives are to improve farm management and the technical capabilities of peasant farmers and to integrate producers from indigenous ethnic groups into the national community. It achieves these objectives through financial and technical assistance, and training.

The Chilean Development Corporation (CORFO) has been the driving force behind the nation's industrialization programs since its creation in 1939. Its first involvement in horticulture was in 1943. It conducted a study on the first cold storage plant dedicated to handling and preservation of different food products. It identified the need to create a chain of cold storage facilities for fruits and vegetables. In 1974 CORFO began funding major efforts to plant orchards with species and varieties most popular in international markets.

Changes in the banking law in 1975 allowed commercial banks to engage in long-term financing, whereas previously only government development banks, including CORFO, could do so. By the late 1970's CORFO had reduced its direct lending and was acting more as a broker, receiving funds from international sources and channeling them to the private sector through commercial banks.

In the late 1980s, it financed studies to assess the potential for the fruit processing industry to use non-exportable fresh fruits. In 1984, it created the Productive Development Fund to provide subsidies for technological research that can be applied quickly by the private sector. Through public bidding, CORFO provides up to 75 percent of the cost of a project. The

---

[147] Chilean acronyms are generally based on the Spanish name of the institution.

results of research are public information unless the project promoter returns the funding at the end of the research.

Promotion Institute for Chilean Exports (PROCHILE) was created in 1974 to diversify Chile's exports (of which copper accounted for 75 percent). PROCHILE promotes Chilean products in international markets, assists potential new exporters, provides market information, establishes commercial contacts, and handles product inquiries from abroad. It also participates in international trade fairs and promotes foreign investment by facilitating contacts between foreign buyers and Chilean suppliers.

The Central Bank defines and implements international trade and monetary policies. It modifies banking regulations to facilitate export activities. It has been instrumental in establishing a foreign exchange rate policy in line with an export promotion strategy. The Central Bank also regulates foreign investments. The Foreign Investment Statute requires official approval of a project but imposes no limit on foreign ownership; it allows investors to remit profits immediately, and capital after the third year of operation.

The Central Bank has also been instrumental in managing debt-for-equity swaps. In May 1985, the Bank created a process to swap Chilean foreign-currency-denominated debt held by foreign institutions for equity in Chilean companies. Chilean debt, like much debt of Latin American countries, sells in the secondary market at a discount from its face value. The law allows foreign companies and individuals to purchase Chilean debt from foreign bank creditors. The Central Bank redeems the debt in pesos at close to its face value. A foreign investor then has to use these funds to invest in a new or ongoing venture in Chile. Capital invested through this procedure may be repatriated after 10 years and profits after four years. The volume of foreign direct investment from debt-for-equity swaps from 1985 to 1991 is $3.6 billion.[148]

International donors, such as USAID, Inter-American Development Bank (IDB), and the World Bank, provide loans to the Central Bank, which through special agreements transfers funds to development and commercial banks, which in turn channel them to the private sector for a pre-defined spread and specific investment purposes. This mechanism stimulates competition among banks for investment projects, accelerating the traditionally slow loan and bureaucratic loan application process.

The **University of Chile**'s School of Agriculture and Forestry Sciences has trained highly skilled professionals since 1874. It operates a number of experiment stations and carries out research funded by CORFO, INIA and SAG.

The National Agricultural Society (SNA) is a 150-year-old organization representing farmers' positions to the government, and analyzing policies and programs that affect its membership and the agricultural sector. It has taken a lead role in defending private property

---

[148] General Accounting Office, 1992, p. 11.

rights. Its professional staff prepares reports published in SNA magazines. It also owns radio stations operating in the capital and three other major cities. SNA has had its own experiment station since 1923. In 1987, it created the first specialized school to train agricultural management technicians.

The **Catholic University of Chile**'s School of Agriculture opened in 1904. It has taken the lead in agricultural economics and fruit production, and it has developed a specialty in pomology, graduating 248 pomologists in the ten years from 1977 to 1987. Since 1984, it has published a bi-monthly magazine that disseminates market information, technological advances, and other relevant topics for national agricultural development. In 1986, in an agreement with the Association of Exporters, it assumed responsibility for the quality inspection of fruit for export.

The Exporters Association was created in 1935. Its membership is almost exclusively fruit exporters, concentrating on expanding international markets and solving export-related problems. In 1980, it signed an agreement with USDA to inspect all fruit and vegetable exports to the U.S. at origin. The Association provides various services to members, including information on export trade, international prices, quarantine programs, and all other matters relevant to the fruit export business.

The Chile Foundation has led the transfer of technology to the agribusiness sector through seminars, quality control services, different types of laboratory analysis, and certification of agricultural products, which produces about 60 percent of its income. It was created jointly in 1976 by the Government of Chile and ITT (International Telephone and Telegraph), each contributing $25 million in start-up capital. The Foundation implements projects to demonstrate the feasibility of the new technologies. By so doing, it takes risk that might be too great for a single entrepreneur and introduces technologies that might not otherwise find their way to Chile. When these technologies have proven successful, the Foundation quickly sells its ventures to investors, thus reinforcing the role of the private sector. For example, the Foundation sold off a project that reintroduced salmon to Chilean waters to a group of Japanese investors.

The emphasis the Chile Foundation has placed on quality control, especially for export crops, has been a major contributing factor to the growth of Chilean agribusiness. Exporters contract with the Foundation and ship products bearing its quality seal, which is recognized in export markets in both North America and Europe. The program verifies the quality of the harvested fruit reaching the packing house, certifies quality by lots according to standards set by the buyers, controls cold storage, and provides other services that ensure the quality of exported products.

The Federation of Fruit Producers (FEDEFRUTA) was created in 1984 by a group of fruit producers who felt the export companies were not treating them fairly. Its main activity has been to establish contact with fruit importers in U.S. and Europe. Its members include both individuals and producers' associations. It participates in a market service that publishes weekly information on volumes and prices of Chilean fruit sold in the main ports of destination. It also organizes a yearly convention of fruit producers.

Improving relations with the Exporters Association has led to creation of a joint Fruits and Vegetables Committee to coordinate all actions aimed at improving the production and marketing of these crops. The Committee began by studying jointly quality control programs, pest and disease prevention programs, and analysis and coordination of shipments to improve marketing conditions in the ports.

7.3.2 The Rapid Growth of Thailand's Fruit and Vegetable Exports

Thailand has had great success in diversifying its agricultural base and accelerating growth in the sector. Starting with maize exports to Japan in the late 1960s, Thailand has become a major exporter of fruits and vegetables, tuna, shrimp, and poultry. Successful policies and well coordinated public/private sector cooperation and collaboration have been key factors in the development of these export industries.

The horticulture sector is a good example. From 1980 to 1988, exports of fruits and vegetables increased 236 percent in volume terms, rising from 20,634 to 69,437 metric tons, and 222 percent in value terms, increasing from $8.1 million to $26.1 million. A major factor in this successful effort was the Thai government's commitment to formulate policies and pursue actions in close collaboration and cooperation with the private sector. Key government agencies, including the Departments of Agriculture and Agriculture Extension in the Ministry of Agriculture and Cooperatives, the Ministry of Commerce's Department of Export Promotion, the Thai Institute of Scientific and Technological Research and Thai Airways International, all played important roles.

The major areas of public/private sector cooperation included:

- Training and research
- Production
- Packaging and processing
- Quality control
- Transportation
- Promotion

Policy Framework. The Thai government has carried out its efforts to support the development of fruit and vegetable exports within a well-defined policy framework. The National Economic and Social Development Board (NESDB) has been focusing on agricultural issues since the first five year plan (1961-1966). The Fifth NESDB Plan, covering 1982-1986 included the promotion of an integrated agricultural system with coordination between the public and private sectors. Emphasis was placed on expanding area and improving productivity and quality control.

The agricultural policies established in the Sixth Plan (1987-1991) focused on actively promoting fruit and vegetable exports through research on improved varieties, improved storage facilities, and the development of pre- and post-harvest technology to meet the quality standards of foreign markets. In other words, the plan followed an integrated, commodity system approach.

Training and Research. Public sector research agencies in Thailand have developed programs to serve the needs of private enterprise. Efforts of the Department of Agriculture (DOA), Department of Agricultural Extension (DOAE) and the Thai Institute of Scientific and Technical Research (TISTR) have focused on fruit fly control and post harvest improvements of quality as well as production and varietal improvement research. Research into such techniques as vapor heat treatment (VHT), hydro cooling, shrink wrapping, waxing and fumigation has contributed to the overall effort to open new markets for Thai fruit and vegetables in Japan, the U.S. and Europe. In addition, the universities, DOA and TISTR organize seminars to inform producers about new development and techniques to increase efficiency, quality and production. The DOAE publishes a bimonthly newsletter for exporters and processors with information about current research, field trials and test shipments, and problems within the industry.

Transfer of Technology. To promote the adaptation of new production techniques, the DOAE transfers applicable technology and procedures to producers at little or no cost. District officers will undertake field trials and demonstrations to introduce changes and convince farmers to adapt them. In some circumstances, the Bank for Agriculture and Agricultural Cooperatives will take an equity position in a new venture to support the adaptation of new techniques.

The public sector in Thailand is prepared to intervene to help solve specific problems. For example, the DOAE used its own funds to remove a key constraint impeding mango producers' ability to export to Japan. Frustrated by his inability to export to Japan, a noted mango producer asked the government to use its influence with Japanese authorities to help him break into this important export market. In response, Thai authorities invited a delegation of Japanese government officials and plant quarantine authorities to visit Thailand and inspect its mango exporting system. As a result of this visit, Japanese authorities agreed to accept Thai mangoes as long they were first processed using a Vapor Heat Treatment (VHT) to guard against fruit fly. In addition, all processing was to be done with Japanese health officials present.

At a price of $1 million, the Japanese-made VHT machines surpassed the financial resources of any one Thai mango exporter, so the DOAE intervened. It used its own resources to purchase and install two machines. To partially offset this expense, DOAE put the operation of the two facilities up for bid, with the stipulation that 50 percent of the throughput was to come from exporters other than the firm awarded the contract to operate the VHT facilities. In taking the financial risk to introduce this new technology into Thailand, the DOAE has benefitted the entire mango subsector.

Quality Control is another area where public sector efforts have supported the fruit and vegetable exporters. The DOA's Plant Quarantine Subdivision subjects all exports to phyto-sanitary inspections. To help preserve the quality of product awaiting shipment from the international airport at Bangkok, Thai Airways International recently purchased equipment costing $5 million which will increase cold storage space by 6,000 cubic meters, exclusively for fruits and vegetables. This is of greatest benefit to smaller producers who do not have cold storage facilities of their own in close proximity to the airport.

Transportation. Thai Airways International has also played a crucial supporting role by providing adequate and timely air cargo facilities for horticultural exports. Not only has the airline established favorable rates, which apply to all carriers shipping from Thailand, but it has established a company policy to make at least half of its cargo space available to perishables. Further, the airline is sensitive to the need to use as much cargo space as is possible during the cooler times of the day for these perishable items.

Still, airfreight can account for up to sixty percent of the retail price of some horticultural products shipped to Europe. With this in mind the DOA collaborated with a private firm on a trial shipment by sea of baby bananas to Denmark. In response to a request from the company, DOA took responsibility for organizing producers, sorting and treating the fruit as well as financial support for the cost of the sea freight. The company was responsible for the packing, loading, shipping and merchandising the product. In this particular case technical problems with the refrigerated container caused excessive chilling en route and resulted in spoilage and a less than marketable product upon arrival in Europe. Nevertheless, public authorities in Thailand continue to work with the public sector to find new and better ways to transport exports.

Promotion. A final area of public/private sector cooperation in Thailand is promotion. The Department of Export Promotions (DEP) of the Ministry of Commerce facilitates contacts between importers and exporters. It maintains a list of selected fruit and vegetable exporters it deems to be reliable suppliers. DEP bases its judgement on a review of the exporter's balance sheet and a written account of the firm's past activities, which the exporter must submit to be considered for listing. DEP maintains 13 offices and finances its operations with a tax on imports.

Collaboration with the private sector plays a critical role in DEP's market research activities. It engages private companies to collect market information and carry out research studies.

7.3.3 Lessons Learned From Thailand and Chile

There are several key lessons that policymakers responsible for formulating a strategy to accelerate growth in Pakistan agribusiness sector can learn from the Thailand and Chile cases presented here. These examples show that **winning strategies for agribusiness growth need to be commodity-specific**. In both the Thai and Chile cases, the government had a coherent plan for the horticulture sector. These winning strategies addressed the unique and distinguishing features of the sector and defined specific, strategic actions to alleviate the constraints that impeded its growth. In both the Thai and Chile cases, government agencies were ready to intervene at specific points along the production-processing-marketing chain to introduce new technologies or procedures that would remove major obstacles to growth.

A second important lesson learned from the Thai and Chile cases is that **winning strategies have clearly defined roles for both the public and private sector**. A well coordinated effort to maximize the unique skills and expertise of the public and private sectors can make a significant contribution to accelerating growth. The Thai case points out several instances when the government was ready to cooperate with the private sector on a cost- and risk-sharing basis. The Chile Foundation has used its joint public-private resources to take risks to introduce new technologies, but once proven successful, i.e. profitable, it has been quick to divest and turn the operation over to a private sector operator.

Both the Chile and Thai cases point out the crucial **importance of** a smoothly operating **quality control** system especially for agricultural products moving into export channels. Again, in both countries there is a high degree of public/private cooperation to make these efforts successful. Government can play an important role here protecting the honest exporter from the unscrupulous. It takes very few shipments of inferior product that does not meet the importing country's standards to give all the exporters in a country a bad reputation.

A **winning strategy for the agribusiness sector needs to pay very close attention to markets**. It is much easier to sell a new product to an established customer or to sell a new customer a product that one has been marketing else where for some time and with success. All too often, however, strategic plans focus on efforts to sell new products to new customers. It is also crucial to identify the key actors in the market. An active broker can provide more accurate, timely information about the conditions in the market and advise which specific products to bring to the market and when than can be deduced from window-of-opportunity and other "arm-chair" types of analysis. People move products through markets, and winning strategies identify who the key people are.

Foreign investment can play a crucial role in accelerating growth in the agricultural sector. Foreign firms bring not only financial resources, but access to technology that may be needed to develop fully a particular comparative advantage, and in depth knowledge about export markets as well.

Land tenure, which is often a sensitive political issue, is also crucial for accelerated agricultural growth. Without clear title to their land, farmers are generally without a way to collateralize loans they need to meet short-term capital needs. It is unreasonable to expect that growth in agricultural output can take place without an increase in the flow of capital to the base of production.

8. RECOMMENDATIONS

8.1 Recommendations of the ACSCA Project and Progress Toward Their Achievement[149]

Before giving recommendations, it will be useful to review the recommendations made by the ACSCA project and the progress made in Pakistan toward achieving them.

8.1.1 General Policies and Actions

1) The Government of Pakistan should make it a policy to recognize and support agribusiness as a distinct economic and corporate subsector.

- The Board of Directors of the AgriBusiness Cell (ABC) will be upgraded to a Ministerial level body.

- Funding to support the ABC shall be pursued from local sources (chambers and associations) and from international institutions (USAID and the ADB).

- The establishment of the private sector Agribusiness Investment Management and Services Co. shall be commissioned.

- A staff member from the Pakistan Agricultural Research Council shall be assigned to work with the ABC.

Progress: Except for pursuing funding from local sources and USAID, none of these steps have been taken yet.

2) Agribusiness shall be a private sector activity.

- No ministry, agency, or bank of the GOP will authorize any new agribusiness investments in enterprises that are directly or indirectly owned by the state.

- Financial institutions under the control of the government will be instructed to cancel all agribusiness loans for expansion projects in state owned enterprises that have not been started.

- An agribusiness privatization program will be implemented.

---

[149] The recommendations in this section are a consolidation of the recommendations made by the ACSCA project, primarily in the document *Toward an Agro-industrial Development Policy*, but also in the case studies and the case study report. See "RONCO" in References.

Progress: A public sector fertilizer plant has been sanctioned recently for the Ministry of Industries, while Pak-China has been privatized. Several ghee mills and most of the tractor industry have been privatized.

3) Agribusiness shall operate in an open and competitive market.

- As a policy test, for a period of two growing seasons, there will be no restrictions on prices, raw materials, or equipment for the growing, processing and sale of any locally grown oil seed, its products, and by-products.

- An Edible Oil Board will be appointed by the Prime Minister from candidates nominated from each of the Provinces to represent all major participants in the industry.

Progress: Not attempted, none.

4) The profitability of agribusiness enterprises shall be respected, but not be specifically favored.

- The MINFAC will charge the AgriBusiness Cell to commission and recommend an equitable tax system for agro-industry.

- The Government of Pakistan establishes that as of January 1, 1992 all banks will provide agricultural and agribusiness credit only at market rates.

Progress: Not attempted. Subsidized credit seems to have returned to agriculture.

5) Foreign investment in agribusiness will be actively solicited.

- The 3 year Work Plan prepared by the ABC for effective performance will be endorsed and submitted by the Minister of MINFAC to foreign funding sources.

Progress: Not submitted to ADB yet.

6) Public Policy

- Pakistan's tax system must be totally reformed.

- Personal and corporate income tax rates must be lowered to a maximum rate of 35% to 38%.

- The super tax and wealth tax must be abolished.

- Sales taxes must be reduced to between 5% and 6% and levied only at the point of final retail sale.

- Octroi taxes must be abolished to promote free inter-provincial transport of goods.

Progress: In the 1992-93 Federal Budget, super and wealth taxes for companies have been combined and included in income tax. A gradual reduction in tax rates in the next five years is envisaged (all rates include wealth and super tax), as follows.

Banking companies: from 64% to 55%
Public companies: (other than banks) from 47% to 30%
Private companies: from 55% to 40%

Import duties have been reduced to a maximum rate of 80%, and the import surcharge of 10% has been absorbed into the import duty.

- Investment tax credits for vital investments in modern marketing infrastructure and production technologies would provide incentives to private sector entrepreneurs to develop agro-industrial business.

- Blanket tax holidays for inconsistent periods of time or specific geographic areas, while in the short run politically attractive, in the long run only cause misallocation of resources and the establishment of inefficient tax avoidance driven industries.

Progress: The Government has announced another tax-free zone for export and foreign investment oriented industries in the 1992-93 budget.

- The state-owned commercial banks must institute loan approvals based on sound financial practices.

- The state-owned commercial banks must be sold to the private sector in a timely manner.

- Development of a dynamic private sector credit market is essential for economic growth.

Progress: Two nationalized banks have been handed over to the private sector. Ten new private banks have also been set up.

- The development of a healthy, dynamic private asset market for equity and debt instruments should be a priority for the Government of Pakistan.

- Existing regulations should be streamlined and designed to aggressively attract and promote the formation of domestic and foreign capital.

Progress: Some improvement in stock market regulations, some influx of capital, substantial increase in market capitalization.

- The Government should improve the breadth and quality of data relating to agri-business and to ensure that such data is easily and freely available to the public.

- The Government should work closely with the private sector to develop and uncompromisingly implement quality and health standards.

Progress: Little or none.

8.1.2 Specific Agro-Industry Policies and Actions

7) The **tractor and implement** companies will operate within a private, market disciplined agro-industry.

- The Pakistan Automobile Corporation will sell its shares in Millat and Al-Ghazi. The Government-owned manufacturers of tractor components may be offered to interested buyers at the same time.

- The price of tractors will be determined by the market.

- The local manufacture of tractors, sub-assemblies and spare parts will compete, in terms of quality and cost, with international standards.

Progress: Tractor and associated companies have been or will be privatized

- Subsidized credit for the purchase of tractors will be phased out over 3 years.

Progress: Concessional credit for tractors at the scale applicable to locally manufactured machinery was given in the Agricultural Policy of 1991. The ceiling for production loans to small farmers was increased from Rs. 1,200 to Rs. 1,600 per acre. In the 1992-93 budget, a 10% percent import duty was imposed on tyres and tubes of tractors. At the same time, the import duty on CKD tractors has been withdrawn.

8) The Government of Pakistan will promote a high risk investment strategy in the **fruit and vegetable** agro-industries.

- The AgriBusiness Cell will provide technical assistance for the planning and testing phase of this strategy, based on the availability of high risk research and development capital from private and public sources (*e.g.*, the ADB Horticultural Project).

Progress: ABC is involved in the ADB Horticultural Project.

9) The Government of Pakistan to continue, within the **fertilizer** agro-industry, its programs of market liberalization and public company privatization.

- Credit for fertilizer shall be at market rates.

- The importation, distribution, and sale of fertilizers will be open to all companies, manufacturing and non-manufacturing, at prices to be determined by the market.

Progress: Subsidized credit for agricultural production, read fertilizer, seems to have returned. Import of fertilizer is nominally open to all, but the Government continues to import DAP and subsidize it, so there is no incentive for the private sector to import it.

- The privatization program will advance, and will include Pak Saudi and National Fertilizer Marketing Limited.

- The MINFAC will execute an improved monitoring of the national flow of fertilizers, prepare forecasts of pre season needs, and set industry standards.

Progress: Pak-Saudi and NFML are on the block to be privatized.

10) **Seed** industry shall be recognized as a private sector activity assisted by public sector research.

- Provincial seed corporations will be sold to the private sector.

Progress: None.

- Government research institutions will be permitted by MINFAC to earn revenues by marketing their seed research facilities and scientific skill to private companies.

- The MINFAC will be instructed to draft legislation for the legal protection of proprietary varieties and hybrids.

Progress: A truth-in-labeling law has been enacted, and a plant breeders' proprietary rights bill has been in the legislative process for a long time.

11) The Government of Pakistan will promote the development of a <u>feed</u> agro-industry in conjunction with the edible oil agro-industry.

- The AgriBusiness Cell will organize and promote within the next year a Livestock and Poultry Feed Conference. It will report on the interest, feasibility, and organization of a market information service for the feed industry.

- The provincial livestock/feed departments will experiment with the establishment of a feed analysis and testing service.

- The feed millers must adopt quality standards for finished feeds and feed inputs and adhere to these standards in order to differentiate commercially mixed products from casually mixed feed.

Progress: None.

8.2 Recommendations of This Study

8.2.1 Overview of Recommendations: Main Thrusts

In section 8.2.2, this study presents a large number of specific recommendations, organized by the chapter in which they first occurred. To bring out the main thrusts behind these recommendations and make their interrelationships clearer, this section provides an overview of these recommendations. It organizes these suggested actions into three areas that should receive priority.

Continue the commitment to the shift in public and private sector roles. Key actions for the Government in this area include ensuring a viable private banking system (free of directed credit and setting its own debt-equity ratios); completing the privatization of key agro-industries like ghee and fertilizer; withdrawing from wheat marketing and subsidies; providing helpful regulation, grading, and standards; investing heavily in human capital and modern infrastructure; and strengthening the AgriBusiness Cell as a facilitating body.

Agribusiness adds value by performing functions that need to be performed. If agribusiness and Pakistan are to prosper together, the notion of the parasitic middleman must be replaced by one of a businessman trying to earn a profit by adding value to the product he receives in response to the needs of the consumer. By the same token, the private sector cannot expect the Government to provide infrastructure and other facilities that the private sector needs without the private sector's contributing fairly to the resources necessary. The private sector needs to take a more mature attitude toward paying taxes.

The process of privatization is important to the Government's credibility and ability to carry out further reforms. It is highly probable that when significant assets are being distributed, there will be disputes over the process. From the sector-wide or economy-wide business point of view, however, the most important thing is that the Government successfully exit from direct or indirect control of production and marketing. The maximum impact is obtained if the Government shifts its priorities to appropriate regulation (not control) and to investments in human capital and physical infrastructure.

For agriculture and agribusiness, one of the most important areas of human capital is the agricultural research system, which can provide both improved crop and livestock species and new agricultural and processing machinery. The Government must consider this system a vital long-term investment, both in the sense that it must be supported consistently over a long period of time and that its benefits continue to accrue over an even longer period of time. These benefits reach farmers, agribusinesses, and consumers. Given that the Government's resources are always limited, it should also try to facilitate the private sector's involvement in research.

Focus on finance for small agribusinesses. Key actions for the Government in this area include establishing an institution, e.g., a private sector DFI, to spearhead lending to small and medium-sized agribusinesses; rationalizing financial procedures, including the treatment of working capital; rationalizing incentive schemes to remove discrimination among old and new firms; providing education in business and banking skills; and completing the establishment of a national credit bureau.

Agribusiness is about half of manufacturing in Pakistan, and small businesses typically create more jobs than large ones. The financial system has historically discriminated against small and riskier agribusinesses, partly by not giving banks control over the interest rate applied to a given loan. Access to credit will allow the private sector to fulfill the role that the above shift would renew. An invigorated agribusiness sector would be in a good position to contribute to vital exports.

Move to an open and consistent trade policy. Key actions for the Government in this area include eliminating all export bans, quantitative restrictions, and export duties on fruits, vegetables, and spices.

Pakistan needs to diversify its exports to stabilize its current account balance and its government revenue. Agribusinesses can help by exporting non-traditional agricultural products. The consistency of the Government's policies, however, is very important to agribusinesses. Ad hocism will hamper investment by creating uncertainty. Foreign investment is also important to export development as it often brings international market contacts and new technology. Substantial progress in exports will not be possible without the quality systems and infrastructure development mentioned above.

8.2.2 Specific Recommendations

The following paragraphs summarize the specific recommendations made in the preceding chapters. Please see those chapters for the complete recommendations.

Chapter 2

- Finance for agribusiness investment should serve a broader clientele.

- Banks and DFIs should be encouraged to develop a stronger focus towards agribusiness, partly by developing managerial evaluation and investment processing skills in this field.

- Financial institutions and industry representatives should coordinate a long-term strategy for share of investment of different agribusiness industries.

- Privatization must be fully implemented, and the role of the government must remain an area of close evaluation.

- The government should simplify investment procedures in agribusiness projects and create a congenial atmosphere for foreign investment.

- Some large locally-based corporations have begun to inject professional managers into their hierarchies, leading to better management. The Government and the private sector should study these cases and extract the relevant lessons for agribusinesses that are growing.

- The supply of properly trained managers in the country is very limited. To remedy this there needs to be a major effort to improve the educational system and expand its reach. The Government needs to streamline the approval process for training to encourage the development of a managerial class capable of managing first-class agribusinesses.

- The Government should take steps to foster the development of companies, whether family-run or not, whether large or small, that function efficiently. These steps include the development of human capital and physical infrastructure and the development and enforcement of grades and standards for both products and services (like accounting).

- The role of Government is setting and enforcing standards, not in deciding the debt-equity ratio, which should be done by private bankers.

- If the Government induced companies to change from private to public limited status, greater transparency might ensue. In the long run, greater transparency would lead to greater efficiency because investment would be channeled to efficient companies.

- The Government could also promote a shift from private to public companies by using not the paid-up capital but the total asset value as the criterion for going public. Before this is recommended, however, it should be studied carefully.

- The Government might require owners of "groups of companies" to provide consolidated accounts. If the Government also required the **merging** of the group's companies, it would bring several more companies into public limited status. Whether this would be a good idea for Pakistan at this time requires further study.

Chapter 3

- The Government should remove itself from wheat marketing, with the possible exception of holding a food security reserve. The details of that reserve and its operation have to be clear to the private sector. To achieve its new status, the Government has to remove the three wheat subsidies: on domestic wheat distribution, on bags, and on imported wheat. There would be new or reduced roles for PASSCO and the Food Departments.

- The Government and the grain industries should make a concerted effort to set quality standards for wheat and rice. The grain management institute being set up by the flour millers is an example of an institutional devlopment that supports this goal. As in this case, the Government should promote the efforts of the private sector to set up standards for quality of products and training to achieve these standards.

- The Government should convert the quantity-based cotton export regime to an explicit export duty with no limit on the quantity exported. The Government should also study the possibility of reinstituting a hedge market in cotton to see if one could be consistent with Islamic principles.

- The Government should promote sugarcane pricing based on sucrose content and strengthen research on sugarcane and sugar processing. The Government should also reconsider supporting the price of sugarcane above the parity price when the crop uses so much scarce water.

- The Government should commission a study to examine consumer preferences in the Gulf and other major importing areas and analyze the competitive position of Pakistan's *basmati* rice.

- A well-enforced labeling law would improve the quality of feed by giving livestock producers better information on the contents of the feed they buy and stimulating competition among feed millers to produce better products.

- The Agribusiness Cell should work with donors to arrange training in feed analysis in anticipation of feed analysis laboratories being set up.

- The current tax incentives for poultry farms should not be renewed. Instead, the Government should rationalize its crop prices (especially wheat) so that the poultry feed industry has an incentive to use maize as the primary ingredient. The Government should also do its best to provide high-quality health and other information, and where possible services, to the industry. The AgriBusiness Cell might be able to assist with information on the possibility of exporting poultry products, particularly to the Gulf.

- In the ghee industry, the most important steps the Government can take are to complete the privatization it has begun and to promote quality standards.

- The Government should with the exception of those commodities on the negative list, eliminate all export bans, quantitative restrictions, and export duties on fruits, vegetables, and spices. The Government should specify the commodities on the negative list by the start of each fiscal year (July 1) and not add commodities to the list during the fiscal year.

- The near-term challenge for the Government in the fertilizer area is to get itself out of the business of production and marketing. This includes completing the privatization of NFC and NFML and ending subsidies and import distribution quotas. A small non-subsidized strategic reserve may be useful to cushion the effect of unusually high international prices or the unavailability of a particular grade, or to serve isolated markets not served by two or more private sector firms.

- The Government should work with the private sector to improve fertilizer use efficiency and encourage the private sector to convey more information on the use of their products at the point of sale. To support proper use of fertilizer, the Government should improve its soil testing facilities.

- Some areas that urgently need research attention include fertilizer use efficiency, wheat varieties that can be successfully planted late (after cotton), non-traditional oilseeds, and combined harvesters that can chop straw finely and deliver it in bags.

- The Punjab and Sind Seed Corporations should be phased out, and the Federal Government should pass a proprietary rights law for breeders to protect the investment in breeding made by private seed companies.

- The AgriBusiness Cell needs to be institutionally established and strengthened so it can play a role in facilitating the development of agribusiness over the coming years.

Chapter 4[150]

- The privatization of the banking sector should be completed as expeditiously as possible.

- The Government should complete its program to discontinue credit ceilings for individual banks so that credit can be allocated by the private sector according to risks and rewards.

- The AgriBusiness Cell should continue its efforts to facilitate investment in the oilseed processing sector.

Chapter 5

- The AgriBusiness Cell of MINFAC should continue to coordinate efforts to identify the constraints that are limiting growth in agribusiness sectors where Pakistan has a

---

[150] Recommendations stemming from both Chapters 3 and 4 are not repeated under Chapter 4.

competitive advantage and to outline ways in which these constraints can be addressed. As part of this effort, the ABC should identify the training and financial needs of existing firms.

- The AgriBusiness Cell should promote a debate or have a study prepared on what constitutes an effective subsidy to agriculture or agribusiness in Pakistan. In general, the Government should provide incentives at the end of the production process or chain, at the point of the goal that they want to achieve, e.g., increased exports.

- The Government should instruct DFIs not to remove working capital from loan applications.

- The GOP should find alternate ways to control speculation in what it considers primary food crops, mostly through the use of free and open markets, not by limiting the amount of working capital that a bank can advance to an agribusiness.

- There is a need for more and better institutions that can undertake detailed, credible, agribusiness project analysis and market the project to institutions for investment funds, especially in the small and medium-sized project area.

- The Government, universities, banks, and private agribusinesses should collaborate to develop training programs for bankers who might specialize in financing high-risk or perishable-product agribusinesses.

- With the formal banking sector becoming more developed, there is a need for an institution, a private sector DFI, that can lead the way for the agribusiness sector. MINFAC should survey the private sector to find a leader who can "get the ball rolling." Once this individual is identified, MINFAC should assist him/her in raising the funds to finance a prefeasibility study. The prefeasibility study, including specific goals for the company, should be circulated among interested parties. Once the legal framework has been set up, the company can be formed and begin the process of preparing the institution. After the procedures have been prepared and the staff hired, marketing can begin. A private DFI should be free of Government regulation regarding the levels of debt-equity ratios.

- There should be no general difference in the investment procedures or incentives for old and new companies.

- Work on the implementation of a national credit bureau should continue as planned.

- The Government should improve the timeliness of industrial cost statistics.

- An important research need is to determine the extent to which different agribusinesses are undertaking financial intermediation, namely lending to farmers.

Chapter 6

- The system of direct and indirect tax incentives should be streamlined.

- The Government should maintain and, where possible, redouble its efforts to broaden the tax base.

- An area where complete coverage would increase the perception of fairness is the exemption of income from agriculture from direct taxation. A way to begin to treat agriculture on an equal basis is to introduce a system of cash accounting.

- If it is determined by the Government that agribusiness is going to play a key role in employment and income generation (and this is certainly possible), then "agribusiness" needs to be clearly defined.

- The Government should work hard to attract foreign investment.

Chapter 7

- Winning strategies for agribusiness growth need to be commodity-specific.

- Winning strategies have clearly defined roles for both the public and private sector.

- A smoothly operating quality control system is of crucial importance, especially for agricultural products moving into export channels.

- A winning strategy for the agribusiness sector needs to pay very close attention to markets. Thus, participation of the private sector in policy dialogues is an important factor that can contribute to agribusiness development.

- Foreign investment can play a crucial role in accelerating growth in the agricultural sector. Foreign firms bring not only financial resources, but access to technology that may be needed to develop fully a particular comparative advantage, and in depth knowledge about export markets as well.

- Land tenure, which is often a sensitive political issue, is also crucial for accelerated agricultural growth. Without clear title to their land, farmers are generally without a way to collateralize loans they need to meet short-term capital needs. It is unreasonable to expect that growth in agricultural output can take place without an increase in the flow of capital to the base of production.

REFERENCES

Abdullah, Mian Mumtaz, Chairman, Corporate Law Authority. Personal communication. May 5, 1992.

"Agribusiness Industry Case Study Report." 1990. Analysis of Corporate Sector Constraints in Agriculture. Islamabad. Draft.

Agricultural Development Bank of Pakistan. 1991. Annual Report, 1990-91. Islamabad.

Ahmad, Junaid K., Walter P. Falcon, and C. Peter Timmer. 1989. *Fertilizer Policy for the 1990s*. Development Discussion Paper No. 293 AFP. Cambridge, MA: Harvard Institute for International Development. June.

Ahmed, Sultan. March 27, 1990. "Towards privatization without perils." *Business Recorder*.

Ali, Imran. 1975. *Punjab Politics in the Decade Before Partition*. Lahore.

______. 1980. "The Punjab Canal Colonies, 1885-1940," Australian National University Ph.D theses.

______. 1987. "Malign Growth? Agricultural Colonization and the Roots of Backwardness in the Punjab." *Past and Present* (Oxford), 114.

______. 1988. *The Punjab under Imperialism, 1885-1947*. Princeton.

______. 1991. "The Punjab and the Retardation of Nationalism," in D.A. Low (ed.), *The Political Inheritance of Pakistan*. London.

______. (Forthcoming). "Telecommunications Development in Pakistan" in E. Noam (ed.), *Telecommunications in West Asia*.

______. "The Wheat Trade in Pakistan" (Lahore Business School, Case No. 14-081-87-1).

"Allied Bank controversy deepens." *The News*. March 1, 1992.

"Allied Bank Limited is the first example of a management-workers' buyout deal." *The News*. August 6, 1991.

Allied Bank of Pakistan. 1991. *Agricultural Review*, XIV, 1. Karachi.

"Allied employees fulfill ownership requirement." *The News*. August 31, 1991.

Asian Development Bank. *Outlook-1991*.

Azam, Qazi Tauqir, Erik A. Bloom, and Robert E. Evenson. 1991. *Agricultural Research Productivity in Pakistan*. Pakistan Agricultural Research Council and Economic Growth Center, Yale University. May.

"Bankers' protest." *Muslim*. July 1, 1990.

Bari, F. "The Zia Years: Stability and Entrenchment" (LBS Case No. 14-092-92-1).

Barrier, N.G. 1966. *The Punjab Alienation of Land Bill of 1900*. Durham, NC.

Bienen, Henry and John, Waterbury. 1989. "The Political Economy of Privatization in Developing countries." *World Development*, 17, 5.

Block, Steven. 1991. *The Cotton Economy of Pakistan*. Agricultural Policy Analysis Project, Phase II Technical Report No. 121. Washington, DC: Abt Associates Inc. September.

Bokhari, Farhan. August 6, 1991. *The News*.

Burki, S.J. 1980. Pakistan under Bhutto 1971-1977. London.

Capital Market Study. 1990.

Chandler, A.D. 1977. *The Visible Hand*. Cambridge, MA.

______. "The Emergence of Managerial Capitalism." (Harvard Business School Case No. 384-081).

______. "The Integration of Mass Production and Mass Distribution" (HBS Case No. 377-031).

Church, Constance. 1990. "State-Owned Enterprises: Do the Ends Justify the Means?" Analysis of Corporate Sector Constraints in Agriculture Project, Ronco Consulting Corporation, November 15.

Coulter, Jonathan. 1991. *The Case for Bulk Storage and Handling of Wheat in Pakistan* (dated February. Paper presented to the "Bulk Handling and Storage Seminar." Lahore, Pakistan. June 17-19, 1991. Storage Technology Development and Transfer Project.

Development Research and Management Services. "Pakistan Informal Sector Study," final report submitted to USAID/Pakistan, March 1991, p. 8.

"ECC policy favours soyabean oil lobby," *Business Recorder*, December 11, 1990.

"Employees given right to purchase nationalised units," *The News*, March 5, 1992.

Ender, Gary. 1991. *The Use of Producer and Consumer Subsidy Equivalents to Measure Government Intervention in Agriculture: The Case of Pakistan*. Agricultural Policy

Analysis Project, Phase II Collaborative Research Report No. 332. Washington, DC: Abt Associates Inc. December.

Ender, Gary, Abdul Wasay and Akhtar Mahmood. 1991. *Wheat Price Policies in Pakistan: Should There Be A Subsidy?* Agricultural Policy Analysis Project, Phase II Collaborative Research Report No. 333. Washington, DC: Abt Associates Inc. and Islamabad: Enterprise Development Consulting, Ltd.

"Fertilizer factory goes to private sector," *The News*, June 16, 1992.

General Accounting Office. 1992. "Chilean Trade - Factors Affecting U.S. Trade and Investment." GAO/GGD-92-106. Report to the Chairman, Subcommittee on International Economic Policy and Trade, Committee on Foreign Affairs, House of Representatives. Washington, D.C.: U.S. General Accounting Office. June.

Gokal, Abbas K. "Privatisation in the Third World." *Pakistan and Gulf Economist*. December 23-29, 1989.

Goldman, Richard H., Malcolm Hall and Agha Imran Hamid. 1991. *Pakistan Edible Oils Policy Study*. Agricultural Policy Analysis Project, Phase II Collaborative Research Report No. 324. Cambridge, MA: Harvard Institute for International Development and Islamabad: Enterprise Development Consulting, Ltd.

"Government to encourage buyout of enterprises: Qadir." *The News*. September 24, 1991.

Government of Pakistan, Agricultural Prices Commission. 1984. *Measures for Improving Efficiency of Sugarcane Production and Sugar Manufacturing in Pakistan*. APCom Series No. 25. November.

Hall, Malcolm and Maliha Hussein. Forthcoming. *Pakistan Animal Feedstuffs Policy Study*. Agricultural Policy Analysis Project, Phase II Collaborative Research Report No. 337. Cambridge, MA: Harvard Institute for International Development and Islamabad: Enterprise Devlopment Consulting, Ltd.

Hassan, N. "Fertilizer Production in the Public Sector" (LBS Case No. 14-041-87-1).

Haq, Dr. Mahbub ul. *Business Recorder*, Aug 24, 1990.

Horticulture export seminar. SRD. June 7, 1992.

Husain, S. Shahid (Vice President, World Bank). 1989. "Four Decades of Economic Development: What Have We Learned?" Speech to Islamabad Council of World Affairs. December 6.

Hussein, M. et al. 1991. *Pakistan Informal Sector Study*. Development Research and Management Services Limited. Islamabad.

"Insecure businessmen demand constitutional cover." *The News*. August 13, 1991.

"Incentives for investment." *Business Recorder*. October 26, 1989.

Jones, Susan , K. 1991. "The Road to Privatization: The issues involved and some lessons from New Zealand's experience." Finance and Development. March.

Kazmi, Wahab. 1991. "Privatization of MCB: Possible Pitfalls." *Pakistan and Gulf Economist*, January 12-18.

Kemal, A.R. 1992. "Pakistan's New Industrial Policy and Financial Markets." *Pakistan Banker*. Lahore: Bank of Punjab. January-June.

Kemp, T. *Industrialization in Nineteenth Century Europe*.

Khan, Mazhar-ul-Haque. 1972. *Purdah and Polygamy*. Peshawar.

Klein, M. 1991. Commercial Banking in Pakistan. Presented at the LUMS seminar on Financing Pakistan's Development in the 1990's, Lahore.

Kornai, Janos. "Privatization: The Great Problem of Transition in Eastern Europe" (Bulletin of the American Academy of Arts and Sciences May 1991 XLIV,8: 32-40.

LaPorte, Robert, Jr, and Muntazar Bashir Ahmed. 1989. *Public Enterprises in Pakistan: The Hidden Crisis in Economic Development*, Westview.

Lodhi, Kamil et al. 1988. *The Pakistan Sugar Industry: An Economic and Policy Analysis*. Pakistan Economic Analysis Network Project, Special Reports Series No. 8. October.

Longmire, Jim. Forthcoming. *Agricultural Pricing Policy and Comparative Advantage in Pakistan: An Update to 1991-92*. Report to the World Bank.

Marketing of Wheat in the Punjab. 1939. Lahore.

Masihuddin, M., Secretary, Privatization Commission, personal communication, July 21, 1992.

Maxon, Richard C. 1991. *Bulk Handling Economics*. Febraury. Paper presented to the "Bulk Handling and Storage Seminar." Lahore, Pakistan. June 17-19, 1991. Storage Technology Development and Transfer Project.

Ministry of Finance. 1992. "Privatization Policy and Its Implementation." Government of Pakistan. January.

Minutes of NCCC meeting. July 25, 1992.

Moizeau, Charles. Privatization Advisor, (ADB), Privatization Wing, Ministry of Finance, November 8, 1990, personal communication.

Moizeau, Charles. 1990. "The Process of Privatization and its Prerequisites." Unpublished mimeo. October.

Mullick, Hussein. 1990. "The Crisis of Development in the Public sector in Pakistan with special reference to agribusiness." Unpublished paper, dated July 18.

Nankani, Helen. 1988. "Techniques of Privatization of State-Owned Enterprises," Vol II. World Bank Technical Paper no. 89.

The News. August 5, 1991.

Papanek, G.F. 1967. *Pakistan's Development*. Cambridge, MA.

"PM takes notice of resistance to privatization." *The News*. June 12, 1991.

Privatization Investment Promotion Group. January 13, 1992. "[To] The Honourable Prime Minister: Facts and Recommendations on the Privatization Process." *The International News*.

"Privatization without parliament's consent." *Dawn Economic and Business Review*. February 23 - March 1, 1991.

"Privatization Policy and Its Implementation." Ministry of Finance. Government of Pakistan. January 1992.

Qadeer, M. 1983. *Urban Development in the Third World*. Lahore.

"Qadir admits WB disapproval." *The News*. October 15, 1991.

"Qadir to give performance report to Parliament." *Dawn Economic and Business Review*. March 1, 1992.

Report on the Marketing of Wheat in the Punjab. 1939. Lahore.

RONCO Consulting Corporation. 1990. *Agribusiness Industry Case Study Report*. In collaboration with AGRI-BI-CON International (Pvt) Ltd. Analysis of Corporate Sector Constraints in Agriculture Project, funded by USAID/Pakistan. December.

______. 1990. *The Edible Oil Agro-Industry*. In collaboration with AGRI-BI-CON International (Pvt) Ltd. Analysis of Corporate Sector Constraints in Agriculture Project, funded by USAID/Pakistan. November.

______. 1990. *The Fertilizer and Pesticides Agro-Industry*. In collaboration with AGRI-BI-CON International (Pvt) Ltd. Analysis of Corporate Sector Constraints in Agriculture Project, funded by USAID/Pakistan. May.

______. 1990. *The Livestock Feed Agro-Industry*. In collaboration with AGRI-BI-CON International (Pvt) Ltd. Analysis of Corporate Sector Constraints in Agriculture Project, funded by USAID/Pakistan. August.

______. 1990. *The Farm Machinery and Implements Agro-Industry*. In collaboration with AGRI-BI-CON International (Pvt) Ltd. Analysis of Corporate Sector Constraints in Agriculture Project, funded by USAID/Pakistan. April.

______. 1990. *The Seed Agro-Industry*. In collaboration with AGRI-BI-CON International (Pvt) Ltd. Analysis of Corporate Sector Constraints in Agriculture Project, funded by USAID/Pakistan. June.

______. 1991. *Toward an Agro-industrial Development Policy*. In collaboration with AGRI-BI-CON International (Pvt) Ltd. Analysis of Corporate Sector Constraints in Agriculture Project, funded by USAID/Pakistan. October.

"Rs. 4 Bn increase in MCB deposits." *The News*. August 8, 1991.

"Running to market." *The Economist*. March 30, 1991.

de Soto, Hernando. 1989. *The Other Path*. New York.

Scott, W.E. and Redding, D.A. 1988. *Agricultural Credit in Pakistan*. Prepared for USAID, Islamabad, Pakistan.

"SPNGL subscription from 27th." *The News*. July 16, 1992.

State Bank of Pakistan. 1991. *Annual Report, 1990-91*. Karachi.

______. 1992. *Bulletin*. Karachi. February.

______. BCD Circular letter no. BCD(CC)/14/127.Priv.92. July 27, 1992.

"State-owned industries" (Editorial). *Business Recorder*. July 20, 1990.

Study of the Cotton Textile Industry in Pakistan. 1979. Karachi: APTMA.

Talat, Javed. Personal communication.

Talha, Mohammad. July 6, 1991. "Privatization: Efficiency of free market enterprise." *The News*. Pakistan.

"TCP to begin soyabean oil auction on 9th." *Business Recorder*. September 3, 1990.

Van der Dungen, P.H. 1972. *The Punjab Tradition*. London.

"Vegetable Oil Industry Ord promulgated." *The News*. April 28, 1991.

Vuylsteke, Charles. 1988. "Techniques of Privatization of State-Owned Enterprises," Vol I, World Bank Technical Paper no. 88.

World Bank. 1992. *World Development Report 1992 - Development and the Environment*. New York: Oxford University Press, Inc.

Zaman, A. "Early Growth of Business Enterprise in Pakistan: 1947-1958" (LBS Case No. 14-080-87-1).

______. "Pakistan's Industrial Development and Business Enterprise in the 1960s" (LBS Case No.14-088-87-1).

ANNEX 1 PERSONS CONTACTED

Islamabad

Kamil Lodhi, Consultant
Development Alternatives Inc.
Afghan Agriculture Program
USAID/REP

Dr. Charles Hatch, Chief of Party
Winrock International
Forestry Planning and Development Project
USAID/GOP

Dr. Imtizaj Husain, Additional Secretary
Chairman, AgriBusiness Cell
Ministry of Food, Agriculture and Cooperatives

Amer Raza, Coordinator
AgriBusiness Cell
Ministry of Food, Agriculture and Cooperatives

Mazahir Husain, Agri-business Advisor
United Nations Development Program
P.O. Box 1051
858579, 822072-79

Ahsan Tayyab, Project Implementation Officer
Asian Development Bank
38 Khayaban-e-Iqbal, F-6/3
818791-4

Dr. A.R. Kemal, Joint Director
Pakistan Institute of Development Economics
824533

John Pott, Chief, Regional Mission
International Finance Corporation
20-A Shahrah-e-Jamhuriat
Ramna 5 (G-5/1)
824166, 819781

Lahore

Nasir Usman Sheikh, Director
Ravi Feed Industries Ltd.
1st Floor, Taj Arcade, 73 Jail Road
483938,480092

Dr. Khalid Chowdhry, Chairman
Medipak Limited
132/1 Industrial Estate, Kotlakhpat
842555-57

Salim A. Faruki, Managing Director
Faruki Pulp Mills Limited
316-17 Alfalah Building
Shahrah-e-Quaid-e-Azam
302364

Mahmood Ali Bhatti, Chairman
Punjab Group of Industries
2nd Floor, Institute of Engineers Bldg.
Main Blvd., Gulberg III
874805, 875228

H. A. Naqvi, Resident Director
Bano Sugar Mills Ltd
2nd Floor, Institute of Engineers Bldg.
Main Blvd., Gulberg III
873519, 874611

Sheikh Ahsan Fazal, Chief Executive
Pak Ghee Industries Ltd. &
Sadoon Textile Industries Ltd.
57 Main Road, Samanabad
415271, 415448

A.T. Naqvi, Managing Director
Rich Green Seed Industries Ltd.
15/16 Medina Market
Ravi Link Road, Fruit Mandi 201244, 486339

Hussein Dawood, Chief Executive Officer
Dawood Hercules
35-A Abdul Hamid Bin Badees Road
301601, 302012

Mumtaz Ahmad Sheikh, Director
Pak Group of Industries
a/10-11 C.B. Centre, Cantt-13
373394, 375194

Zahid Rahim, Managing Director
Ali Chick & Ali Poultry Breeding Farm
63 Alfridi Mansion, Shadman Market
481734, 442223

Nusrat Yar Ahmad, Senior Manager &
Nile Rabbani Awan, Executive-Investment Banking
Interbank
2nd Floor, Maryum Building
85 Shahrah-e-Quaid-e-Azam
306906-9

Nazir Ahmad Alvi, Chief Executive
Farm Development Industries
177-A, Badami Bagh
201905

Tariq Hameed, General Manager, Finance
& Mr. Rashid, Founding Director
Bank of Punjab
7 Egerton Road
365065

Khalid Niaz Khawaja, Executive VP
Muslim Commercial Bank
Circle Office, Bank Square
323761

<u>Karachi</u>
Husain Lawai, President
Muslim Commercial Bank
Head Office, Adamjee House
I.I. Chundrigar Road
2417831, 2413903

Mr. Ainuddin, Director Industrial Credit
State Bank of Pakistan
Shaheen Complex, 9th Floor
I.I. Chundrigar Road
2637034, 2630265

Mr. G.M. Kerhati, Sr. Executive V.P.
Habib Bank Limited
Habib Bank Plaza, 20th Floor
228008, 219111x276

Rashidullah Yacoob, Chairman
House of Prudential
Prudential House
Off I.I. Chundrigar Road
2630860, 2630866

Safdar Rashid, Chief Executive &
Khalid Rashid Sadique, G.M. Finance
B.R.R. Group
Dean Arcade, Block 8, Kehkeshan
Clifton 572012, 537225-6

Humanyun Murad, Managing Director
Orix Leasing Pakistan Limited
Chamber of Commerce Building
Talpur Road (Off I.I. Chundrigar Road)
2426020-9

Sabir Ali Hashmi, SVP Credit &
Nisar Ahmad Ansari, SVP
National Bank of Pakistan
Credit Division, 11th Floor
Head Office
I.I. Chundrigar Road
2416987

Khalil Sattar, Managing Director
K & N Poultry Farms (Pvt) Ltd,
K & N's Agriculture & Poultry
Breeding Farms (Pvt) Ltd,
Adil Feeds (Pvt) Ltd

401-406, Noor Estate Building
Shahrah-e-Faisal
439541, 439533

Younus Farooqi, Acting Director &
Zafar Hasnain Siddiqui, Deputy Director
Agricultural Credit
State Bank of Pakistan
PNSC Building, 6th Floor
551056-9

Syed Shaida Hasan Zaidi, Exec. VP &
Jamil Ahmed, VP &
Amir Ali Hassan Ali, Officer
Agriculture & Small Finance Division
Tahir Saeed Effendi, Exec. VP
Credit & Corporate Division
Allied Bank of Pakistan
NIC Building, 13th Floor
Abbasi Shaheed Road 519561

Huzair Soomro, Manager
Banque Indosuez
Muhammadi House
I.I. Chundrigar Road
2417155

Nisar H. Effendi, Chairman & CEO
Sindh Abadgar's Sugar Mills Ltd
164-L, Block 3, PECHS
4559741, 4557936

Abdul Shakoor, Executive Vice President
Agro-Industries Division
National Development Finance Corporation
Finance & Trade Centre, 2nd Floor
Shahrah-e-Faisal
525108, 526241

Annex Table 2 Pakistan: Financial Concessions and Special Rights for Agribusinesses and Other Sectors

	AGRO-INDUSTRY						
	LIVESTOCK, DAIRY, POULTRY & FEED	FRUITS & VEGETABLES	FERTILIZER & PESTICIDES	EDIBLE OIL	FARM MACHINERY	OTHER AGRO-INDUSTRIES	MANUFACTURING AND MINING
1. FINANCIAL CONCESSIONS							
1.1 INCOME AND EXCISE TAX DEDUCTIONS, ETC.							
EPZs and EPUs		75% of export income tax exempt; rebate on juices, squashes, chutnies, syrups, jams on condition of exporting 3 products				25% income tax rebate on cotton yarn; income tax rebate of 75% on textile garments, woven woolen fabrics, leather garments and articles, bed linen, footwear and parts; textiles, furniture, and leather eligible for Open Bond Scheme	Industries eligible for Open Bond Scheme for EPU: chemicals, engineering, ceramics, sports goods, surgical instruments; 75% of export income tax exempt for electrical machinery & equipment, engineering goods, surgical instruments, furniture, pharmaceuticals, ceramic tiles, cutlery, 50% for all other manufactured goods
CENTRAL EXCISE DUTIES		Vegetable products exempt; fruit juices: Rs. 10/unit		Non-essential vegetable oils are exempt		Sugar: Rs. 2.15/kg, tobacco: Rs. 2.2/kg, cigarettes: 75% of retail price, paper and board: Rs. 30/kg, cotton yarn: Rs 6/kg, tea, coffee, beet sugar, leather products, cotton fabrics, woollen yarn and fabrics exempt	Cement: Rs. 508/ton, POL group, gas, electric appliances, tires, soap detergents, paints varnishes, cosmetics

Annex Table 2 Pakistan: Financial Concessions and Special Rights..., cont'd

	LIVESTOCK, DAIRY, POULTRY & FEED	FRUITS & VEGETABLES	FERTILIZER & PESTICIDES	EDIBLE OIL	FARM MACHINERY	OTHER AGRO-INDUSTRIES	MANUFACTURING AND MINING
INCOME TAX: 5-year holiday in rural areas, exemption for EPZs until 2000	5-year income tax holiday for poultry, poultry processing, sheep breeding, dairy, fish farms set up from July, 1988 to June, 1993; poultry, fish farms set up after June, 1991 exempt for 8 years		4-year tax holiday for a company set up from July, 1988 to June, 1993; 2-year income tax exemption on pest control services		2-yr income tax exemption on rental income from agri-cultural machinery for business set up before June, 1990	Tax rates: Income tax 30%, super tax 20% on private companies, 15% on public companies; exemption of profits of Pakistani companies engaged in rendering agro-services has been withdrawn	15% tax credit on investment in plant and equipment for balancing, modern-ization, & rehabilitation by a Pakistani company; 5-year tax holiday for pioneering industrial undertaking owned & managed by a Pakistani company and for certain engineering goods; 4-year tax holiday for companies set up by June, 1993 solely engaged in manufacture of biotechnology goods, fiber optics, computers and software electronic equipment, solar energy equipment; 15% tax credit for balancing, modernization, & rehabilitation and extension of industrial projects engaged in manufacture of goods for shipbuilding, supply of electric hydraulic energy

Annex Table 2 Pakistan: Financial Concessions and Special Rights..., cont'd

	LIVESTOCK, DAIRY, POULTRY & FEED	FRUITS & VEGETABLES	FERTILIZER & PESTICIDES	EDIBLE OIL	FARM MACHINERY	OTHER AGRO-INDUSTRIES	MANUFACTURING AND MINING
GENERAL TAX CREDIT 30% of the industrial investment in Balochistan, Tribal Areas, Northern Areas or Azad Jammu & Kashmir; dividend income in first 10 years of any private sector company in industry, agriculture, mining, tourism, consultancy is tax exempt							Pakistani lessors of machinery get 15% tax credit on purchase price; 5-year tax holiday on export of certain minerals
1.2 IMPORT AND EXPORT LEVIES AND EXEMPTIONS							
IMPORT DUTIES	Fowl 20%, meat 80%, fish 80%, milk 60%, milk cans and pails 40%	Vegetables 80%, fruits 90%, nuts 90%, 100% duties on sugar confectionery, fruit & vegetable preparations 90%, kraft paper 20%, yogurt 80%	Insecticides 30%, fertilizers free	Soy oil Rs. 1,000/MT, palm oil Rs. 1,500/MT, sunflower Rs. 3,000/MT	Tractors 10%	Sugar 10%, tanning paints and dyes 80%, packing material 80%	

Annex Table 2 Pakistan: Financial Concessions and Special Rights..., cont'd

	LIVESTOCK, DAIRY, POULTRY & FEED	FRUITS & VEGETABLES	FERTILIZER & PESTICIDES	EDIBLE OIL	FARM MACHINERY	OTHER AGRO-INDUSTRIES	MANUFACTURING AND MINING
EXPORT DUTIES		1/2% *ad valorem* on fruits, vegetables, dry fruits, spices				Basmati rice ($440/MT), cotton (MEP-C52/kg) 41%, cotton yarn Rs. 3/kg, raw hides 15%, IRRI rice 30%, raw skins 15%, molasses 25%, camels Rs. 2500, wheat 1/2%	

Annex Table 2 Pakistan: Financial Concessions and Special Rights..., cont'd

	LIVESTOCK, DAIRY, POULTRY & FEED	FRUITS & VEGETABLES	FERTILIZER & PESTICIDES	EDIBLE OIL	FARM MACHINERY	OTHER AGRO-INDUSTRIES	MANUFACTURING AND MINING
CUSTOMS DUTY & SALES TAX EXEMPTIONS (key industries include bio-technology, fiber optics, solar energy, electronics and fertilizer.)	Plant and equipment for livestock, dairy farms, feed lot units, feed mills & dairy processing (if not locally manu); poultry feed micro ingredients by feed millers, medicines & chemicals imported by dairy or livestock farms; packing raw material for dairy products	Raw material for manufacture of packaging, grading, processing of fruits & vegetables; import of non-aerated beverage machinery, refrigerated transport lorries	Plant and equipment for expansion of existing fertilizer units, raw material for manufacture of pesticides for agri. fertilizer machinery		Raw material for manufacturing of farm implements, e.g., rubber; exemption on sprinklers, hydrapump, precision land levelling equipment, drip irrigation raw materials & components not locally manufactured can be delivered without duty payment	Aerial ropes & skyline cranes exclusively for forest exploitation; goods imported by fishermen cooperative societies; plant and equipment for textile garments & processing, leather industries imported under balancing, modernization, & rehabilitation; weaving and ginning, hosiery and towels, cutlery, tanning, hybrid seed production/processing units; raw material for manufacture of textile machinery parts jute mills, industrial sewing mach., sugar plants, tea driers, bee farming, wood seasoning are subject to nominal rate	Plant and equipment imported by PASMIC, for sound recording media, cutlery goods, onyx/marble, ordinary & portland cement; compressors, thermostats, picture tubes, power plants; scientific & medical instruments, jewelry, mining and shipping industry, machinery for balancing, modernization, & rehabilitation, pharmaceutical raw material, engineering goods, machinery for manufacture of exports, spares for manufacture of sports, surgical goods, raw material and components for manufacture of: ship spares, local manufacture of vehicles, capital goods and machinery used in oil & gas exploration

Annex Table 2 Pakistan: Financial Concessions and Special Rights..., cont'd

	LIVESTOCK, DAIRY, POULTRY & FEED	FRUITS & VEGETABLES	FERTILIZER & PESTICIDES	EDIBLE OIL	FARM MACHINERY	OTHER AGRO-INDUSTRIES	MANUFACTURING AND MINING
CUSTOMS DUTY EXEMPTIONS	NRI concession on import of livestock machinery, milk collecting lorries	Potatoes, onions, green tea 29%, corn, millet, sorghum; NRI concessions for horticulture, *e.g.*, greenhouses	Power sprayers for pesticides		NRI concession on tractor harvesters, implements for tilling, planting	NRI concession on import of machinery, air conditioning & chilling plants are customs tax exempt for balancing, modernization, & rehabilitation	(See import policy for complete list)
SALES TAX EXEMPTIONS (Normally 12.5% *ad valorem* on all taxable items)	Animals, dairy produced in Pakistan	Fruits, vegetables, nuts, tea, chilies, breads, aerated water produced in Pakistan	Imported agricultural pesticides, local fertilizers	Soy/vegetable fats other oils locally produced	Locally manufactured machinery	Exemption on locally-produced fabrics, furniture, yarns, sugar, footwear	Sales tax exemption on goods produced for exports, by cottage industries, to save double taxation, on imports, key industries output machinery or parts for industrial use if manufactured in Pakistan
SURCHARGE EXEMPTIONS	15% exemption on meat & poultry processing machinery	Red chilies, onions	Fertilizer, sulphur and phosphate rock used for manufacture of fertilizer, plant and equipment for fertilizer plants		CKD tractors	Goods imported for manufacture of leather made-ups; fishing vessels	

Annex Table 2 Pakistan: Financial Concessions and Special Rights..., cont'd

	LIVESTOCK, DAIRY, POULTRY & FEED	FRUITS & VEGETABLES	FERTILIZER & PESTICIDES	EDIBLE OIL	FARM MACHINERY	OTHER AGRO-INDUSTRIES	MANUFACTURING AND MINING
EXPORT REBATE/ DUTY DRAW BACK (Import duties paid by exporters refunded at time of export)	Animal products 0-1.1%	Prepared foods and packaging 2-20%; vegetable products 1-15%				Rebate on custom duties, sales & excise taxes as a percent of fob value on hosiery, cloth, towels, other textile articles 2-27.5%; hides and leather products 9-20%; paper materials 3-30%; footwear headgear 7-27%	Chemical, plastic products 2-34%; machinery, appliances 6-32%; transportation equipment 0-28%; base metal articles 6-25%
1.3 CREDIT SUBSIDIES AND GUARANTEES							
CONCESSIONAL EXPORT FINANCE (for all exporters) @ 7% for 180 days	Fish, mutton and beef, feed stuff for animals, live animals ineligible	Crude vegetable material (except roses, chilies) ineligible	Crude fertilizer ineligible	Oilseeds, nuts, kernels ineligible		Raw cotton, cotton yarn, wool and animal hair, hides and skins, fur skins, wet blue leather, all grains are ineligible	Jewelry, crude minerals, metals, petroleum products, antiques are ineligible
CREDIT INCEN-TIVES	Production loans for small farmers will be extended to livestock, poultry and fish farming on a yearly basis					No restrictions on credit to sugar mills against sugar stocks; minimum margin restrictions of 25% against advances for all rice varieties except basmati; debt/equity ratio of 80:20 for certain agro-industries like sericulture, wood/carving sawing;	Small loans for business purposes enhanced to Rs. 300,000; industries with fixed assets of originally Rs. 20 million will qualify for small loans; loans to private sector power projects up to 50% of foreign exchange cost and repayment 30 yrs

Annex Table 2 Pakistan: Financial Concessions and Special Rights..., cont'd

	LIVESTOCK, DAIRY, POULTRY & FEED	FRUITS & VEGETABLES	FERTILIZER & PESTICIDES	EDIBLE OIL	FARM MACHINERY	OTHER AGRO-INDUSTRIES	MANUFACTURING AND MINING
2. SPECIAL RIGHTS							
2.1 RAW MATERIAL IMPORTS							
RESTRICTED IMPORTS		Brewery machinery, ban on manufacture of non-industrial alcohol	Ingredients for formulation of pesticides by industrial consumers			Swine and products, beverages and spirits, textile products, addictive drugs, luggage items, articles of apparel & clothing accessories, woven fabrics, furs, footwear, jewelry, retreaded tires	Transmission apparatus, vehicles, air conditioners, public transport vehicles, CKD transportation, sports goods, carpets, artillery, metal jewelry
CONDITIONAL IMPORTS	Animal semen is subject to MINFAC approval	Edible products need licensing	Insecticides, herbicides registered with MINFAC, meet labelling and packaging requirements		Tractors/power tillers		
2.2 PRODUCT EXPORTS							
EXPORT INCENTIVES AND REBATES	50% of UHT milk produced by a unit can be exported	Fruit & vegetable processing in EPZ; fruits, horticulture, cut flowers				Garments, leather and wooden products in EPZ; fish processing units are EPU	

Annex Table 2 Pakistan: Financial Concessions and Special Rights..., cont'd

	LIVESTOCK, DAIRY, POULTRY & FEED	FRUITS & VEGETABLES	FERTILIZER & PESTICIDES	EDIBLE OIL	FARM MACHINERY	OTHER AGRO-INDUSTRIES	MANUFACTURING AND MINING
EXPORT BAN (export of imported items allowed if a minimum of 10% increase in value)	Live sheep, beef & mutton, animal fat, milk & milk products, certain brans and fodder, corn meals and feeds	Pepper, pulses, beans		Edible oil (vegetable & butter oil), oilseeds		Wheat, *gur* (unrefined sugar), wet blue leather, wild animal skins, hides & skins, charcoal, timber, empty wooden crates, paper waste	Ferrous and non-ferrous metals
RESTRICTED EXPORTS	Buffalos, cows, goats, camels, minimum fob price in US dollars; wild boars by non-Muslims only	Citrus, chilies, potatoes, mangoes, meeting quality control restrictions	Fertilizer authorized by Ministry of Industries as exportable surplus	Graded oilcakes		Wheat flour/bran, other byproducts, fish (grading) quotas for maize, gram, split gram, barley, textile quota (MFA), rice bran. Rice subject to EPB contract	Cement, onyx, stones and jewelry; petroleum exported only through public sectoR
EPU NEGATIVE LIST	Hides & skins, live animals, blue leather	Fruits, vegetables, cereals		Oilseeds		Cotton yarn, wood, natural fibers	Primary, unprocessed mineral products

Annex Table 2 Pakistan: Financial Concessions and Special Rights..., cont'd

	LIVESTOCK, DAIRY, POULTRY & FEED	FRUITS & VEGETABLES	FERTILIZER & PESTICIDES	EDIBLE OIL	FARM MACHINERY	OTHER AGRO-INDUSTRIES	MANUFACTURING AND MINING
2.3 OTHER							
PRIORITY AREAS FOR FOREIGN INVESTMENT	Feeding and fattening ingredients for livestock	Canning and preservation of fruits	Chemical fertilizers			Byproducts of sugarcane/sugar, textile weaving (banned: agricultural land, irrigation, forestry)	Chemicals, mechanical engineering items, metallurgical products, machinery and equipment, electrical/electronics foreign manufacturers exporting more than 50% of production have unlimited domestic working capital credit. Other foreign manufacturers can take a rupee loan equal to their equity
SANCTIONING							Required only for arms and ammo, security printing, explosives, and radioactive substances industries

Annex Table 3 Taxation and Investment Incentives in Pakistan and Selected Asian and North African Countries, 1991

	PAKISTAN	EGYPT	MOROCCO	TUNISIA	INDIA	INDONESIA	MALAYSIA	PHILIPPINES	THAILAND
ECONOMIC PROFILE									
Population	116 million	55 million	26 million	8 million	843 million	186 million	18 million	63 million	59 million
GNP Growth	5%[1]	1%[2]	4%[149]	7%	2%[149]	6%[149]	12%	1%	8%[149]
Inflation	13%	25%	7%	8%	12%	9%	4%	17%	6%
Per Capita GDP	$370	$650	$920[3]	$1,550	$240[150]	$590[148]	$2,370[148]	$720	$1040[148]
Agriculture/GDP	26%	20%	18%	17%	34%[3]	23%	19%[148]	27%[148]	12%
Government Revenue from Direct Taxes[4]	12%		23%[5]		15%[6]	20%[7]	36%[8]	21%[9]	
Agricultural Imports (% total)	$1.1 billion (14%)	$5.3 billion (33%)		$0.5 billion (12%)		$1.8 billion (8%)	$6.3 billion (8%)[148]	$1.0 billion (9%)	$2.8 billion (7%)

[1] 1990.

[2] GDP.

[3] 1989.

[4] Unless otherwise indicated, information is from the "Price Waterhouse Information Guide to Doing Business" for each country.

[5] Calculated from the IMF's *International Financial Statistics*, May 1992 and the Price Waterhouse's "Doing Business in Morocco;" figures for total direct taxes are from 1987 and revenue figure is from 1988.

[6] Calculated from the IMF's *International Financial Statistics*, May 1992 and the Price Waterhouse's "Doing Business in India."

[7] 1989-90 estimate.

[8] 1990.

[9] 1987.

Annex Table 3 Taxation and Investment Incentives (cont'd)

	PAKISTAN	EGYPT	MOROCCO	TUNISIA	INDIA	INDONESIA	MALAYSIA	PHILIPPINES	THAILAND
Primary Agricultural Imports	Edible oil, tea, sugar, wheat, tallow, dried milk powder	Wheat, forest products, meats, vegetable oil	Wheat, dairy products, meat	Grains, wood, sugar, edible oils, consumer goods		Wheat, dried milk, cotton lint, veg. oils, soybeans, peanuts, garlic	Cereals, fruit/vegetables, sugar & preps, oilseeds, non-cereal animal feed	Dairy products, wheat, soybean meal, tobacco, cotton, forest products, fruits, vegetables	Milk, butter, wheat, tobacco, cotton, animal oils, fats and greases, soybean oil, forest products
Agricultural Exports (% total)	$4.4 million (65%)	$1.1 million (6%)		$.55 billion (16%)		$7.2 billion (28%)	$21.2 million (27%)[148]	$1.3 billion (16%)	$9 billion (23%)
Primary Agricultural Exports	Cotton & products, rice	Cotton, fruits and vegetables	Fresh fruits and vegetables, canned fruit, wine, tomatoes, olives	Olive oil, fish products, fruit, dates, wine, tobacco		Rubber, coffee, rattan, palm oil, spices, essential oils, shrimp, plywood	Cork & wood & prods., crude rubber, vegetable & other oil	Coconut products, bananas, pineapple, sugar, tobacco, forest products	Rice, fruit, cassava, sugar, maize
Primary Trading Partners	US, Japan, EC	EC, US, Australia, Japan	EC, US	France, Italy, Germany, Belgium	EC, US, former USSR, Japan	Japan, Taiwan, Hong Kong, US, Netherlands	Japan, US, Singapore, Taiwan, S. Korea, EC	US, Japan, EC, ASEAN	US, Japan
INVESTMENT CLIMATE									
Foreign Direct Investment 1990 (IMF)	$242 million	n.a.	$165 million	$59 million	n.a.	$964 million	$2,902 million	$530 million	$2,303 million
Registered Foreign Investment	U.S. Only - $.3 billion	$2 billion, est.	$.600 billion, est.	$.21 billion	$.75 billion, est.	$4.53 billion	$6.2 billion	$3.3 billion	$3.7 billion
Primary Foreign Investors	US, Japan, Germany, UK, Saudi Arabia, Kuwait	US, UK, France, Germany, Japan, Italy	EC members, U.S.	France, Italy Germany, Belgium, Netherlands, Saudi Arabia	EC, US, Japan	Japan, Hong Kong, U.S., Germany, Netherlands	Singapore, US, Japan	US, Japan, Taiwan, Hong Kong	Taiwan, Japan
***Institutional Investor* Ranking and Credit Rating[10] (March 1992)**	Rank: 62 Rating: 28.0	Rank: 71 Rating: 24.9	Rank: 57 Rating: 29.7	Rank: 46 Rating: 38.7	Rank: 48 Rating: 37.6	Rank: 33 Rating: 50.6	Rank: 26 Rating: 62.6	Rank: 67 Rating: 25.7	Rank: 25 Rating: 62.8

---

10 *Institutional Investor* ranks the credit ratings of all countries bi-annually. The rank reflects a country's position relative to the rest of the world; the rating is a number assigned to the credit-worthiness of a country from 1 to 100, 100 den a perfect credit rating.

Annex Table 3 Taxation and Investment Incentives (cont'd)

	PAKISTAN	EGYPT	MOROCCO	TUNISIA	INDIA	INDONESIA	MALAYSIA	PHILIPPINES	THAILAND
Govt. Attitude Towards Foreign Investment	Welcome; still bureaucratic & infrastructural impediments	Generally welcome	Welcome	Welcome, but high level of intervention & control	Welcome on a case-by-case basis; prefer <51% foreign	Welcome in open industries; restrictions may be discouraging	Welcome in open industries; restrictions may be discouraging	Welcome as source of jobs, technology, exports	Welcome for development, jobs, technology, exports
Labor Attitude Towards Foreign Investment	Generally welcome	Welcome due to better salaries & benefits	Welcome	Welcome	Welcome due to professionalism & better salary	Generally welcome as source of jobs	Generally welcome	Welcome for better salaries & benefits	Welcome, some labor shortages
Intellectual Property Rights[11]	Enforcement weak; WIPO but not Paris convention; only processes, not products, can be patented	Enforcement weak but improving; WIPO & Paris convention	• Enforced; WIPO • Patents good for 20 yrs.	Good Enforcement; WIPO & UNCTAD	• Enforcement weak; neither WIPO nor Paris Convention • Patents for food, medicines 7 yrs.; all else, 14 yrs.	• Enforcement generally good; WIPO • Patents short at 14-16 yrs.	• Enforcement generally good; WIPO • Patents good for 15+ yrs.	Enforcement generally good; WIPO	• Enforcement weak; WIPO • Patents for products, 7 yrs., inventions 15 yrs.
Comparative Labor Costs	Unskilled - $53/mo. Skilled - $80/mo.	Unskilled - $56/mo.	Unskilled - $83/mo. Skilled - $124/mo.	Unskilled - $96/mo. Skilled - $133/mo.	Unskilled - $44/mo. Skilled - $83/mo.	Unskilled - $40/mo. Skilled - $145/mo.	Unskilled - $46/mo. Skilled - $75/mo.	Unskilled - $96/mo. Skilled - $117/mo.	Unskilled - $72/mo.

11 WIPO = World Intellectual Property Organization, a United Nations specialized agency with international guidelines for protection of intellectual property; UNCTAD = United Nations Center for Trade and Development also has some guide for intellectual property protection; Paris convention for the protection of industrial property.

Annex Table 3 Taxation and Investment Incentives (cont'd)

	PAKISTAN	EGYPT	MOROCCO	TUNISIA	INDIA	INDONESIA	MALAYSIA	PHILIPPINES	THAILAND
REPATRIATION AND FOREIGN OWNERSHIP									
Repatriation of Capital	Guaranteed up to the amount of the original investment	Guaranteed, but foreign exchange not guaranteed	• Guaranteed; four day wait for foreign exchange • Limits on annual amounts	Guaranteed if Central Bank approves amounts	Guaranteed; exchange control formalities required	Guaranteed	Guaranteed; may need exchange control license, but usually not hard to get	Guaranteed, no approval necessary	Guaranteed if liquidate enterprise; Bank of Thailand approval takes 2 wks.
Repatriation of Profits	Guaranteed	Guaranteed, but foreign exchange not guaranteed	• Guaranteed; four day wait for foreign exchange • 3% export earnings may be retained for travel	Guaranteed if Central Bank approves amounts	Guaranteed; exchange control formalities required	Guaranteed	Guaranteed; may need exchange control license, but usually not hard to get	Guaranteed, no approval necessary	Guaranteed 50% net profits for first 6 mos., then 100% net profits; Bank of Thailand approval takes 2 wks.
Repatriation of Dividends	Guaranteed	Must have approval of Investment Authority	Guaranteed; four day wait for foreign exchange	Guaranteed if Central Bank approves amounts	Guaranteed; exchange control formalities required	Guaranteed	Guaranteed; may need exchange control license, but usually not hard to get	Guaranteed, no approval necessary	Guaranteed net dividends; Bank of Thailand approval takes 2 wks.
Foreign Ownership of Companies	Permitted	Permitted	Permitted	<50% permitted	• General ceiling of 51% foreign ownership • Up to 74% if meet national interest criteria • If 100% exporter, can be 100% foreign owned	• 80% foreign ownership permitted, falling to 49% in 15 yrs.; If export >95%, can own 100% • Investment ltd. to 30 yrs., but renewable	If employ >350 Malays or export >50%, can be 100% foreign owned; If export 20-49%, 30-51% foreign owned; if export <20%, 30% foreign owned	100% foreign ownership allowed: • if industry not on restricted list; • if export >70% output (no restricted export industries); • for pioneer enterprises; and • Export Processing Zone Cos.	• Majority foreign ownership prohibited in some businesses • US-Thai treaty gives US more freedom • 100% exporters can be 100% foreign owned, 50% exporters can own majority
Foreign Ownership of Land	Prohibited	Permitted with "inland" real estate, housing, hotels, land reclamation (see Free Zones)	• Permitted for all but agricultural land • 99 year leases for agricultural land	• Prohibited • <40 yr lease on public land if company majority owned by Tunisians	Prohibited	Prohibited Foreigners may: • Lease ag land for 35 yrs., renew to 60 yrs. • Own real estate for 20-30 yrs., renewable	• Permitted, but not encouraged; • 99-year leases for agricultural land available	• Prohibited unless corporation has <40% foreign equity • May lease	• Permitted in industrial estates and petroleum concessionaires; • If equity >50% foreign, may own land for duration of project

Annex Table 3 Taxation and Investment Incentives (cont'd)

	PAKISTAN	EGYPT	MOROCCO	TUNISIA	INDIA	INDONESIA	MALAYSIA	PHILIPPINES	THAILAND
INVESTMENT INCENTIVES									
Priority Sectors	Dyes, food processing, agro-chemicals, selected machinery, electronics	Any that do not compete with Public sector industries	Industrial tourism, for-export, maritime, and mining investments	Agriculture (cereals, red meats, mink, olive oil, fish prods.), fishing, manufacturing	High-tech, ships, hotels, machinery, chemicals, pharmaceuticals soya prods., ag processing /packaging (ex. dairy)	Tourism, oil & natural gas, mining, forestry, agriculture, communications, transport, some manufacturing	Manufacturing and agro-industry	Non-traditional manufactured exports	Encourage petroleum & energy, portfolio investment, export diversification
Regional Development Incentives	• 5 yr. tax holiday, No: duties, sales tax, license fee on equipment: • Northwest Frontier Province; Balochistan; Federally Administered Tribal Areas, Northern Areas, Azed Kashmir, Dera Ghazi Khan, Bahawalpur Sukkur Larkkana	10 yr. tax exempt for new industrial estates, some urban communities, remote areas.	• No taxes for cos., individuals in Western Sahara • Four zones, with varying investment incentives in North, East & South outside of urban centers • Zone 4 exempt from equipment import duties, 50% land cost subsidy, partial loan refund	• State pays 50 to 100% infra-structure costs and first 5 yrs. of social security • Gabès, Gafsa, Béjà, Médenine, Tatouine, Tozeur, Kébili, Bizete, Jendouba, Kélibia	• New industries in designated backward areas deduct the standard 30% of profits plus additional 20% for 10 yrs. • Infrastructure subsidies vary by state	Increased foreign participation permitted in provinces or regencies designated by the government	Abatement of 5% profits (tax exempt) yearly for 5 yrs. if locate in promoted industrial area as designated by government	Less-developed areas receive: • All tax incentives & labor expenses & infrastructure costs tax deductible for 5 yrs. • Bonded manufacturing, simpler Customs, consignment of equipment, employment of foreign nationals for 5 yrs.	3 zones w/varying incentives for all regions except: Kanchanaburi, Samut Prakan, Suphanburi, Angthong, Nonta Buri, Chonburi, Samut Song-khram, Nakhon Pathom, Samut Sakhon, Saraburi, Nakhon Naok, Pathum Thani, Bangkok, Ayutthaya, Ratchaburi, Chachoengsao

Annex Table 3 Taxation and Investment Incentives (cont'd)

	PAKISTAN	EGYPT	MOROCCO	TUNISIA	INDIA	INDONESIA	MALAYSIA	PHILIPPINES	THAILAND
TAX INCENTIVES									
Income tax reduction on profits	• 4 yr. tax holiday • Poultry/fish operations, 8 yr. holiday; breeding farms, 5 yr. holiday; fertilizer plants, 4 yr. holiday • 50-70% rebate for exporters • Some ag land use, production income tax free	• 5 yr. tax holiday for foreign firms, hotels • Plus 2 yrs. if >60% local machinery used • Expatriates exempt if work for <1 continuous yr.	50% exemption from corporate taxes for 5 yrs.	• 10-yr. exemption, 5% for next 5 yrs. • <70% less for agriculture investments • Transferable securities <10% share value for first 5 yrs. are exempt	• New industrial projects may deduct 30% profits for 10 yrs.	• No tax holidays, investment credits or other write-offs	• 5-10 yr. tax holiday for promoted activities in manufacturing, ag, hotel /tourism or 5 yrs. in promoted areas • Up to 100% tax holiday for other activities	• 4-6 yr. tax holiday • Deduction of 50% labor expenses for first 5 yrs.	Joint ventures or >50% exporters: 3-8 yr. exemption on profits and dividends, and 5 yrs. on withholdings remitted abroad
Turnover tax relief on local inputs	No taxes on exported goods	Duty drawback on exports	Duty drawback on exports	Suspension on: • capital goods • construction • services	None	VAT drawback on exports	Duty-drawback on exports	Tax credit on taxes/duties on raw materials used for export	None
Customs duties reductions on imported inputs	• No import duty, license fee, education tax on: • Inputs to exports; key industries; less-developed-area industries • If export >70%, imports of equipment, parts, inputs also sales tax exempt • Packaging, processing, refrig. cars also duty & sales tax exempt	Duty drawback on imported inputs when exported	• Exemption for water/energy/ environmental equipment • < 45% customs duties plus 12.5% import tax unless reexported • Duties refunded on exports via duty drawback	• Reduction on seedlings, livestock, compost, fertilizer, young fish, seeds imports not produced locally • Exemption on all imports for reexport • <15% on imported equipment	None	• If export >65%, exempt from import duties & VAT on inputs, machinery • Duty drawback on imported raw materials if exported • Imported inputs to exports permitted if price lower than domestic inputs	• If not avail. locally, exemption granted for imported inputs to exports & for finished goods for the domestic market • Machinery & equip. not avail. locally import duty & tax exempt	Duty & tax exempt on: • Capital equipment (& tax credit for imports 1987-91) • Breeding stock /genetic material (& tax credit for imports 1987-91) • Spare parts for consigned equipment • No export/port taxes	Joint ventures or >50% exporters: • 50 to 100% reduction of duties on imported machinery • 90 to 100% reduction on imports of raw materials

Annex Table 3 Taxation and Investment Incentives (cont'd)

	PAKISTAN	EGYPT	MOROCCO	TUNISIA	INDIA	INDONESIA	MALAYSIA	PHILIPPINES	THAILAND
VAT reduction	Exports exempt	Exports exempt	Following are exempt: exports, fertilizers, animal feed, fishing boats, ag material, equipment & tools; 19% on agribusiness	None	• Credit for tax on inputs before processed into final product except tobacco, textiles, mineral oil, aerated waters • Exports tax exempt	Duty/Stamp tax exempt: • Construction equip., oil/gas goods/equip. • Ag commodities until processed • Capital goods for 5 yrs. or until useless • Export zero rated	Duty drawback on exports	Exports zero-rated	Exemption for at least one year if production is mainly for export
Other Breaks for Exporters	• No sales tax on exports • 75% income tax rebate on export earnings from textiles, leather garments, engineering goods	No taxes if >80% exported from free zone - treated as foreign entity	• 50% exempt for first 5 years • Tax/import duty reimbursed for 7 yrs. in company ratio of exports to total sales	• Corporate profits from exports exempt • 40% personal income from exports exempt • Profits from local sales (<20% of profits from exports) exempt	• Corporate profits from exports exempt • If export 100%, income tax exempt • If export >25% output, may buy diesel fuel at lower international price	No tax holidays	• Tax-free profit abatement of 50% in ratio of exports to total sales plus 5% value of local inputs • Export allowance of 5% FOB value of sales	None	None
Other Special Tax Provisions	• Export Processing/Free Trade Zones, below • Financial assistance avail. at 8% to develop rural areas	Export Processing/Free Trade Zones, below	• Tax holidays are offered in priority sector industries • Profits from agribusiness are tax-free to the year 2000 • All investment exempt from stamp tax on stocks/shares	• Refund of transfer fees on ag lands • Special programs for young farmers, fishermen, technicians, agricultural investment services, disadvantaged regions • BMWs, below	• Higher depreciation allowances • R&D fully deductible • Subsidies to tea, coffee and cardamom companies are tax exempt • Export Processing/Free Trade Zones, below	• Generous depreciation rates for foreign investors • Export Processing Zones	• Labuan offshore financial center/ tax haven • Export Processing/Free Trade Zones, below	• Special incentives for regional headquarters • Offshore banking units w/special tax incentives • Exempt from local contractor's tax • Export Processing Zones, below	• Regional investment incentives for 125 specified sectors • Petroleum cos. have special incentives, lower taxes

160

Annex Table 3 Taxation and Investment Incentives (cont'd)

	PAKISTAN	EGYPT	MOROCCO	TUNISIA	INDIA	INDONESIA	MALAYSIA	PHILIPPINES	THAILAND
Social Security coverage	None; 2% after tax income must be contributed	None; Employers must pay 24-26%, employees 11-14% of monthly salary	None; employer pays 10% wages + 3.8% max mo. wage + 1.6% payroll, employee pays 1.9% mo. wage	• In rural areas w/investment incentives, state pays first 5 yrs. • For export industries, state pays employer contribution of 20% wage; employees pay 6.25% wage	Exempt for first 3 yrs., then employer pays 15% wages + COLA + small % to pension & gratuity; employee pays 12.25% of wages + COLA	No social security system	None; Employers pay 12.75% wages, employees 9.5% wages	None; employer remits total contribution	No social security system
NON-TAX INCENTIVES									
Feasibility study funds	None	None	None	TD 5,000 or 1% of total investment cost	None	None	None	None	None
Start-up grants	Subsistence farmers receive interest-free loans	Input subsidies to farming, access to state machinery, energy subsidies	None	Agricultural SMEs granted <15% of total investment if 10% owner equity in co.	Subsidies to ag ventures, e.g. tea plantations, for housing, replanting, etc.	None	None	None	None
Start-up low-interest loans	• Machinery export loans at 3-4.5% • If export >50% can borrow unltd. working capital w/out Gov't approval • Loans for: locally manu-factured machinery, sericulture, apiculture, wood carving, sawing industry • World Bank & donor loans	Loans to cotton producers	• Variety of working capital loans/supplier credits available to all investors • World Bank & other donor loans	• Low interest (<10%) or no interest loans for ag. projects • Large projects of TD 500,000 loaned <TD 75,000 10-13 yrs. at 6%	• Soft loans to some industries, e.g. jute textiles • Cash compensatory support & replenishment licenses • Interest concession on public project loans	None	None	None	None

Annex Table 3 Taxation and Investment Incentives (cont'd)

	PAKISTAN	EGYPT	MOROCCO	TUNISIA	INDIA	INDONESIA	MALAYSIA	PHILIPPINES	THAILAND
Equipment subsidies	None	None	None	<10% of total cost of ag. equipment	None	None	None	None	None
Training subsidies	None	None	None	Total or partial payment	None	None	Double tax deduction allowed	Assistance to Export Proces-sing Zone firms	None
Export credit finance	5 mos. at 7%	None	• Capital goods export loans • Export insurance	None	• Concessional pre- and post-shipment credit	Export credit finance at subsidized rates avail. to all foreign joint-ventures	Finance and insurance at subsidized interest rates for exporters	None	None
Export Subsidies	None	None	None	None	None	None	None	None	None
Bonded Manufacturing Warehouses (BMWs)	None	None	• Private & public warehouses for 2-3 yrs. • Temporary admission 2 yrs.	Companies which export 100% output may locate anywhere & be duty and tax free	None	Permitted countrywide w/Customs approval	Permitted countrywide	Permitted countrywide for registered export industries	None
Export Processing Zones (EPZs)	• Karachi • Exempt from taxes, duties, exchange control, most labor laws	• Cairo, Port Said, Suez, Alexandria, Ismailia • If >80% of output exported, tax & duty free	None	None	• Bombay (electronics), Madras, Noida, Cochin, Falta • 5 yr. income tax exemption, reduced duty & sales taxes, imports on OGIL, can sell 25% locally	• Jakarta and Batam Island • Duty free, allow 95% foreign ownership, no divestiture • Planned for Cakung, Cilacap, Surabaya, Ujung Pandang, Medan/Belawan, Semarang	• Bayan Lepas, Bukit Baru, Mukim Pringgit, Pasir Gudang, Prai, Sungei Way, Tanjong Kling, Telok Ulu Klang, Panglima Garang • For firms exporting > 80% output, duty-free	• Bataan, Cavite, Baguio City, Mactan • 4-6 yr. tax holiday, duty-free imports, 100% foreign ownership allowed, foreign nationals can work for at least 5 yrs.	None

Annex Table 3 Taxation and Investment Incentives (cont'd)

	PAKISTAN	EGYPT	MOROCCO	TUNISIA	INDIA	INDONESIA	MALAYSIA	PHILIPPINES	THAILAND
Free Trade Zones (FTZs)	• Lahore, Multan Peshawar, Islamabad, Faisalabad; • Planned for: Baluchistan, NW Frontier Province • Above exemptions	• Domestic "inland" investment in tourism, land reclamation, industry housing, real estate • Tax & duty free	• Tangier • 50% tax reduction & duty free • Planned for: Agadir & Jorf Lasfar (new port)	• Being built in Zarzis & Bizerte • Gov't will pay cost of all services	• Kandala; one approved for Vishakapatnam • Same incentives as above	None	• Free ports at Labuan Island (finance, heavy industry) and Langkawi Island (tourism)	• 6 industrial estates, some w/EPZs in them, with above incentives; • Dasmarinas, General Trias, Santa Rosa (2), Cabuyao, Tarlac	None; two industrial estates in Laem Chabang & Map Ta Phut; since imported raw materials & machinery are duty free, these act as free zones
Preferential Trade Agreements[12]	GATT	With Iraq, Jordan, Yemen; GATT	Union Maghrébine Arabe, GATT	Union Maghrébine Arabe, GATT	Bilateral accords w/E. Europe, LDCs, GATT	ASEAN, GATT	ASEAN, GATT	ASEAN, GATT, EC GSP	ASEAN, GATT

[12] The UMA consists of Algeria, Libya, Mauritania, Morocco and Tunisia. ASEAN consists of Brunei, Indonesia, Malaysia, the Philippines, Singapore, and Thailand.

Annex Table 3 Taxation and Investment Incentives (cont'd)

	PAKISTAN	EGYPT	MOROCCO	TUNISIA	INDIA	INDONESIA	MALAYSIA	PHILIPPINES	THAILAND
INVESTMENT RESTRICTIONS AND DISINCENTIVES									
Restricted Industries	• Beverages w/alcohol & imported concentrate, tractors & farm machinery, 7 other non-ag industries • No foreign investment in ag land, real estate, forestry, irrigation, 3 other non-ag	None, except local participation may be required and competition w/public sector discouraged	Restrictions removed, in process of privatizing all industry	9 closed: Olive Oil, Dates, Wine, Wheat, Legumes, Reconstituted Milk, Beef, Vegetable Oil, Sugar	Closed: metallurgy, electrical, electronics, transport, industrial & ag machinery, machine tools, pharmaceutical,medical & scientific supplies, fertilizers, chemicals, dyes, paper, veg. oils, rubber, leather, glass, cement	• 60 Closed, of which: Milk; palm oil, rattan, processed wood prods., fertilizer, some transport, machinery, medicine, ethyl alcohol, services • Closed unless 100% for export: poultry breeding, alcoholic drinks, fireworks, gas lighters, motored tricycles	• Most open • Closed: public utilities and services, e.g. telecommunications, rail, postal services	Foreign ownership is: • Prohibited in media, services retail, coops, security agencies, mining, rice & corn industries • Limited in: recruitment to 25%; advertising to 30%; natural resources, lands, public utilities, education, SEC cos., firearms, bathhouses, gambling, drugs to 40%; construction 25-40%	Closed: agricultural activities (can be waived if Thais own $\geq$60% capital); certain manufacturing & food processing that use local resources; most professional services
Licensing/ Approval Process	• If >\$50m, Gov't requires application & feasibility study • Up to 60 days approval; No "one-stop" shop • Import license takes 24 hrs. but hard to get	• Import license required, hard to get • Investment approval takes 20 days but may be denied for arbitrary reasons • Must show economic benefit of industry	• Prior import approval required • Licenses required for some imports • 5-10 days for Customs clearance • 6-10 weeks to establish a business	• Registration fee • Minister of Agriculture determines eligibility for tax benefits	• Investment w/ >51% foreign equity must be approved; approval highly subjective, lon-- • Urge indigenization of 80% inputs in 5 yrs. • 2-3 yrs. wait for licensing of joint ventures	• Joint ventures only, must be approved	Joint ventures encouraged unless 100% exporter	To qualify for tax breaks: • Must register w/Board of Investment (BOI) or EPZ Authority (EPZA) • Use local raw materials • Meet a ratio of capital equip. to workers • Net foreign exchange earnings of \$0.5 m	• Foreign majority ownership only allowed if export >50% • Only 125 activities/sectors eligible for investment incentives • Board of Investment approval in 60 days

64

Annex Table 3 Taxation and Investment Incentives (cont'd)

	PAKISTAN	EGYPT	MOROCCO	TUNISIA	INDIA	INDONESIA	MALAYSIA	PHILIPPINES	THAILAND
Partnerships, Joint Ventures	No limits on % foreign equity but approval more likely if initial capital local	• Minimum foreign equity participation • Generally produce for local market • Taxed as shown below	Joint ventures are not legal entities, but are treated as partnerships	All agricultural investment must be through joint ventures, can be majority foreign owned	• Up to 51% foreign have automatic entry, treated equally with Indian cos. • >51% foreign discouraged	All foreign investment through joint ventures with 80% foreign equity, must drop to 49% in 15 yrs.	Encouraged except for 100% exporters	Joint ventures encouraged	Joint ventures encouraged.
Employment Restrictions	None, but must register all workers	Allowed <10% foreigners receiving <20% payroll	None	Up to 4 foreign nationals per foreign operation	No restrictions but Gov't sets targets for Indianization	• Can hire expatriates only if position cannot be filled by Indonesian • Work permits not hard to get for managers	• Some limits; key personnel may be expatriates; other executives may be for 10 yrs., technical staff for 5 yrs.	• May be employed with firms registered w/ BOI, EPZA • foreign nationals ≤5% total labor force and work 5 yrs.	• Granting of work permits is discretionary • Closed to foreigners: Professional services, manual labor, handicrafts
Price Controls	Generally free, except intervention in wheat, sugar, cotton, basmati rice, pharmaceuticals, etc.	Gradually being freed, but consumer staples subsidized	Only controls on sugar, milk bread/wheat, cereals, edible oil, gasoline	Comprehensive, do not account for quality in some cases	Comprehensive	Comprehensive	Comprehensive	Controls on ag prods: wheat flour, sugar, veg. oil, pork, chicken meat, rice, milk	Ceiling prices on majority of agricultural commodities

Annex Table 3 Taxation and Investment Incentives (cont'd)

	PAKISTAN	EGYPT	MOROCCO	TUNISIA	INDIA	INDONESIA	MALAYSIA	PHILIPPINES	THAILAND
Import and Export Controls	• Many banned products • Avg. nominal tariff 67% • Consumer goods 95% or banned • Additional 10% plus 5% education tax on all imports • Gov't requires local assembly operations to progressively increase local content • 1% fee on free trade zones if no entry/exit of product	• Avg. tariffs 37%; staples 1%, luxury items 160% • Phyto-sanitary barriers • 105 banned items-rice, fruits & vegetables, cattle & beef, live poultry & meat, swine, fish (except tuna), eggs, lard, cotton, veg. oil, bread, honey, cheese, margarine, beverages, processed ag prods. • No export of grains, oilseeds, feed; tariffs & quotas on some items	For imports: • Prior approval necessary • No products banned, but 10% licensed • Avg. tariff 19%; min. 12.5% For exports: • No taxes, licenses required • Export proceeds must be received within 90 days after arrival	Reduction of tariffs to minimum leviable for agricultural products, unless grown in Tunisia	• Imports of consumer goods & processed ag products banned • Commodities imported by State only • Raw materials & components under OGIL • Licensing and tariff policy reviewed yearly, import policy good for 3 yrs. • Tariffs on: raw materials 40-60%; Semi-processed goods 60-100%; finished prods. 100-300% • No tariffs if reexported	• Import license required for many items • Rice, wheat, sugar, soybean, some steel, transport & paper items imported by State only; • Tariffs for Prods. defined as: most essential 0-10%; essential, 10-40%; less essential, 50-70%; luxuries, up to 200%	• A few restrictions for health & security • Import duties from 20-60% foods <5%, consumer goods 60% • Most items under OGIL, but some import licenses required -no delays likely	Tariffs 15-55% plus 5% across the board	• Avg. tariff 23.5% • 3,000 items have tariffs of 10-600%; consumer prods. 40%, capital goods 25%, others avg. 16.5%
TAXATION									
Foreign corporations	Corp. tax rate 55%, dividends tax 15-20%	Outside of "inland" & EPZ, < 75% individual, <42% corporation, <34% exporter	• Corporate rate 44% + 19% VAT • Plus 10-20% on income transferred abroad • Or 12% lump-sum payment	• Corporate rate 35%; fishing, agriculture, crafts 10% • Income tax 35%	• Avg. corporate rate 55%, joint ventures 50-60% • Dividends 25-30% • Capital gains 40-50% • Individuals 27-58%	• Avg. corporate rate: income 35% dividends 35% • Individual 35% + 10% VAT	• Avg. corporate rate 35%+4% development tax • Individual 6-40%	• Avg. corp. rate 35% • Individual expatriate 15%	• Avg. corporate rate 35%, remitted profits 20% • 14 types of firms also pay business tax of 1.5-40% • income tax 5-55%

186

Annex Table 3 Taxation and Investment Incentives (cont'd)

Principal references:

Government of Pakistan. 1991. *Economic Survey 1990-91—Statistical Supplement.* Islamabad: Government of Pakistan.

International Monetary Fund. 1992. *International Financial Statistics.* (May) Washington, DC: International Monetary Fund.

Price Waterhouse. 1990. *Information Guide to Doing Business in Egypt.* New Maadi: Price Waterhouse World Limited.

________. 1990. *Information Guide to Doing Business in India.* Calcutta: Price Waterhouse World Limited.

________. 1989. *Information Guide to Doing Business in Indonesia.* Jakarta: Price Waterhouse World Limited.

________. 1990. *Information Guide to Doing Business in Malaysia.* Kuala Lumpur: Price Waterhouse World Limited.

________. 1991. *Information Guide to Doing Business in Morocco.* Casablanca: Price Waterhouse World Limited.

________. 1989. *Information Guide to Doing Business in the Philippines.* Metro Manila: Price Waterhouse World Limited.

Shapiro, Harvey D. 1992. "A Turn for the Better?" *Institutional Investor,* March 1992, 101-6.