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Investment Policy Review

Khyber Pakhtunkhwa

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ABSTRACT

The Government of Khyber Pakhtunkhwa has already drafted an Investment Policy for the Province and it has requested USAID-funded SMEA project to review the policy and provide recommendations for improvement. This report not only provides a rapid review of the draft investment policy but also highlight various areas that need to be addressed by the revised policy.

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EXECUTIVE SUMMARY

Investment is central to economic growth, driving job creation and boosting an economy's productive capacity and income growth. International investment in particular is also useful as a source of technology transfer. Yet, net inflows of FDI in Pakistan have declined steadily over the last ten years. The investment expected under the ongoing China Pakistan Economic Corridor initiative should contribute towards reversing that trend. However, it will be important to have in place a good investment policy framework to ensure that investments that promote economic growth, technology transfer and domestic employment are encouraged, but that negative spillovers such as environmental degradation are kept at bay.

The Government of Khyber Pakhtunkhwa has already drafted an Investment Policy for the Province and it has requested USAID-funded SMEA project to review the policy and provide recommendations for improvement. This report not only provides a rapid review of the draft investment policy but also highlight various areas that need to be addressed by the revised policy.

Specific comments on the draft policy pertain to need for appropriate diagnostics for sector selection to make sure that the sector-specific incentives are economically efficient (i.e. that they benefit KP more than the revenue forgone or cost borne in incentives); the fact that actions that are required of investors are couched in non-committal terms and non-binding and the benefits that they are offered are not conditional of such actions. Moreover, some of the incentives are neither back loaded nor performance based, which may be revised. Some suggestions are also given to improve the implementation arrangements.

This report also highlights some areas that can inform revision of the draft investment policy such as some diagnostics that cover economic, social and environmental factors for sector selection; a few design principles for investment incentives; improving the overall value proposition of the investment policy; undertaking institutional reforms in a number of complementary areas; embedding transparency, predictability and consistency; re-asses the need for having an investment law and aligning the draft policy with industrial policy 2016 as well as more exhaustively covering the industrial estates. The report also provides the outline of investment policy work being undertaken in Punjab.

The draft investment policy by KP provides a very good starting point to develop a robust investment policy framework in the province. This note provides a few areas that can be worked on to improve the draft policy before it is approved. The government however must realize that approval of such a policy will be the first step in a very long journey towards creating an enabling environment for domestic and foreign investors.

1. INTRODUCTION

1.1. BACKGROUND & INTRODUCTION

Chemonics International is implementing Pakistan Small and Medium Enterprise Activity (SMEA), which is a 5-year, $35 million project that is aimed at improvement of financial and operating performance of small and medium enterprises (SMEs) in Pakistan in selected high-performing industrial, manufacturing and services sectors.

Creating an enabling business environment is one of the core work streams of this project. Moreover, investment is central to economic growth, driving job creation and boosting an economy's productive capacity and income growth. International investment in particular is also useful as a source of technology transfer. Yet, net inflows of FDI in Pakistan have declined steadily over the last ten years. Measured as a percentage of GDP, FDI is now well below the average for both South Asia and for lower-middle income countries.

The investment expected under the ongoing China Pakistan Economic Corridor initiative should contribute towards reversing that trend. However, it will be important to have in place a good investment policy framework to ensure that investments that promote economic growth, technology transfer and domestic employment are encouraged, but that negative spillovers such as environmental degradation are kept at bay.

This requires building a competitive environment for investment, an enabling regulatory structure, and an attractive set of incentives. This can be done through several integrated policy arms including investment policy, investment promotion and facilitation, trade policy, competition policy, tax policy, public governance and financing for investment.

As such, the Project engaged with the Government of Khyber Pakhtunkhwa to identify key areas of collaboration. The Government of Khyber Pakhtunkhwa has already drafted an Investment Policy for the Province and it has requested SMEA to review the policy and provide recommendations for improvement.

This report provides a rapid review of the draft investment policy and highlights various areas that need to be addressed by the revised policy.

2. Comments on Existing Draft Investment Policy

Government of Khyber Pakhtunkhwa has developed a draft investment policy for the province. Following are some specific comments on the draft, while in subsequent sections some issues are identified that the investment policy may cover and also include some guidance based on international literature.

2.1. Strategic sectors

The Investment Policy lists the following sectors as priority sectors, for which further incentives are available: oil and gas, hydropower, tourism, minerals, trade and logistics, agriculture and livestock, infrastructure/transport, ICT, economic zones development and human capital.

If sector-specific incentives are to be offered, it is important to ensure that the incentives are economically efficient (i.e. that they benefit KP more than the revenue forgone or cost borne in incentives). For this, due diagnostics should be undertaken. It is not clear what the basis for sector selection has been, and whether these diagnostics have been run.

In a subsequent section, the report also describes a two-step process for sector identification and incentive design that can inform sector selection by Government of KP. The first step evaluates the benefits of the sector, and the second step designs tailored incentives in proportion to these benefits, and such that they ensure that the benefits are realized. Sector-specific incentives also require coordination with federal sectoral policies. Rather than overalp with these sectoral policies, the federal Investment Policy remains sector agnostic, taking the view of setting uniform conditions for all sectors, and leaving sector specific policies to the relevant line ministries. This is a recommended approach for provinces as well, which avoids duplication and overlaps. Instead, certain activities can be incentivized, such as investments in research, technical skills development and capacity enhancement of suppliers.

2.2. Incentives for Investors

While the details of the provincial investment incentives committed by the Government of KP are not provided for each sector, the Annexes provide some details for a selection of sectors. Subsequent sections provide some fundamental principles for designing investment incentives, however some specific comments are given below:

- The actions that are required of investors are couched in non-committal terms e.g. they are “encouraged” to invest in capacity building, but this is non-binding, and the benefits that they are offered are not conditional on such actions.
- Some of the incentives are neither back loaded nor performance based. Examples include exemption on sales tax, discounts on interest rates, discounts on land, rent and

energy bills and transportation fees. These commitments are being made up-front and are not subject to targets such as employment, location in particularly disadvantaged areas, commitments to labor training or R&D etc. Good practice incentives are those that offer rebates once certain criteria have been met. Making incentives conditional on building absorptive capacity of labor or local firms, for example, would be an example of a more targeted investment incentive. The government of Maharashtra, for example, offers employment based incentives for new units in the ten districts that perform worst in Maharashtra in the Human Development Index. Similarly, an interest rate subsidy is paid out but only for investments in fixed capital assets in selected sectors. Sales tax exemptions are also available, but only on raw material used for exported products. There are additional subsidies for SMEs, such as a subsidy on quality certification, capital equipment for upgraded technology and patent registration expenses. These are examples of targeted subsidies that are conditional on firms making investments that enhance that economic impact on the local economy, rather than blanket unconditional subsides.

- It is not clear what terms the land will be provided on – is it to buy, or on lease? What is the length of lease?
- Incentives should be offered after a Cost-Benefit analysis and should be time-limited, performance-based and subject to extension following a pre-announced evaluation schedule

2.3. GUIDING PRINCIPLES

The given guiding principles are all uncontroversial. However, it would be useful to add specifics. For example, transfer of technology and human resource development are both critical for the benefits of investment to be fully realized, but which specific policies will be in in place to encourage this? Similarly, for example, eco-friendliness, soft financing, gender equity etc. are all a function of active policy and regulation. Specific policies would be required to encourage them.

2.4. STAKEHOLDERS AND THEIR ROLES

This is a list of supporting policies for investors who sign MoU with the government for investment in one of the strategic sectors listed above. Most of these are uncontroversial. Some comments are given below:

- Section 7.1
    - One-window facilitation system – this could include licenses and permissions.
    - Infrastructure development could include effluent treatment plants
    - Clear and clean land title – does this imply ownership? A long lease might be the preferred solution.
    - Are there any labor training or facilitation measures?

- Any scope for facilitation with labor and other regulatory bodies? i.e. facilitation in operations rather than just start-up. This is also important for investor after-case and expansion.

- Section 7.2, 7.3 and 7.5
  - Role of investors are not binding, and it is not clear what kind of benefits there may be to contributing to the suggested objectives or what kind of penalties there may be for non-compliance. Similarly for civil society and development partners, there is no mechanism suggested for their engagement.
  - A useful route to arrive at the suggested corporate behaviors is through CSR initiatives and voluntary standards, however these are voluntary rather than binding, and are not uniform across firms. Requiring large firms to collect and report data on sustainability related activities and control system ("sustainability reporting") can help the Governments of KP evaluate the impacts of policies and incentive systems, and act as soft encouragement, while at the same time not deterring investment by making the requirements binding. These reporting requirements can be voluntary for smaller firms to avoid excessive burden.

- Section 7.4
  - Is there a formal mechanism for engagement with academia? Simply suggesting this is unlikely to yield positive results. A possible avenue for collaboration would be to ensure regular data collection which can be shared with academics for public policy research including impact evaluations

2.5. POLICY IMPLEMENTATION SUPPORT AND MONITORING MECHANISMS

- The mandate of the Committee suggested in 8.1 should also include evaluating the investment policy, including the incentives offered. Investment policy should be managed dynamically to ensure that it remains relevant and effective in light of changes in national and KP strategy, external factors and changing circumstances, and in case it or parts of it) are found to be ineffective.

- The KP Board of Investment and Trade can also take the role of:
  - Political prioritization (Identify investments that are in national interest, which are scalable and for which there is a political consensus)
  - Regulatory preparation (pre-clearing regulatory aspects and pre-approval of market support mechanisms, targeting incentives and permissions required)
  - Packaging (feasibility studies, bundling into packaged projects)
  - Identifying local partners and supporting linkages with local labor and local enterprises

- After-care services, so that investment is not restricted to new investors but also includes re-investment and expansion.

3. KEY ISSUES

This section highlights a number of issues that need to be addressed in the investment policy, lays down some guiding principles for thinking through investment policy frameworks and identifies diagnostic work that needs to be undertaken.

3.1. PRIORITISING POLICY ACTIONS

Several studies and surveys have explored what investors are looking for when deciding which country to invest in. The relative importance of these determinants is important is deciding the policy priorities for attracting investment. One of the most comprehensive studies, the World Bank Global Investment Competitiveness (GIC) report, uses data from a survey of investment perspectives collected from executives of multinational corporations investing in the developing world. The survey shows that market fundemantals are the key factor that investors consider in their investment location decision. This is shown in Figure 1 below.

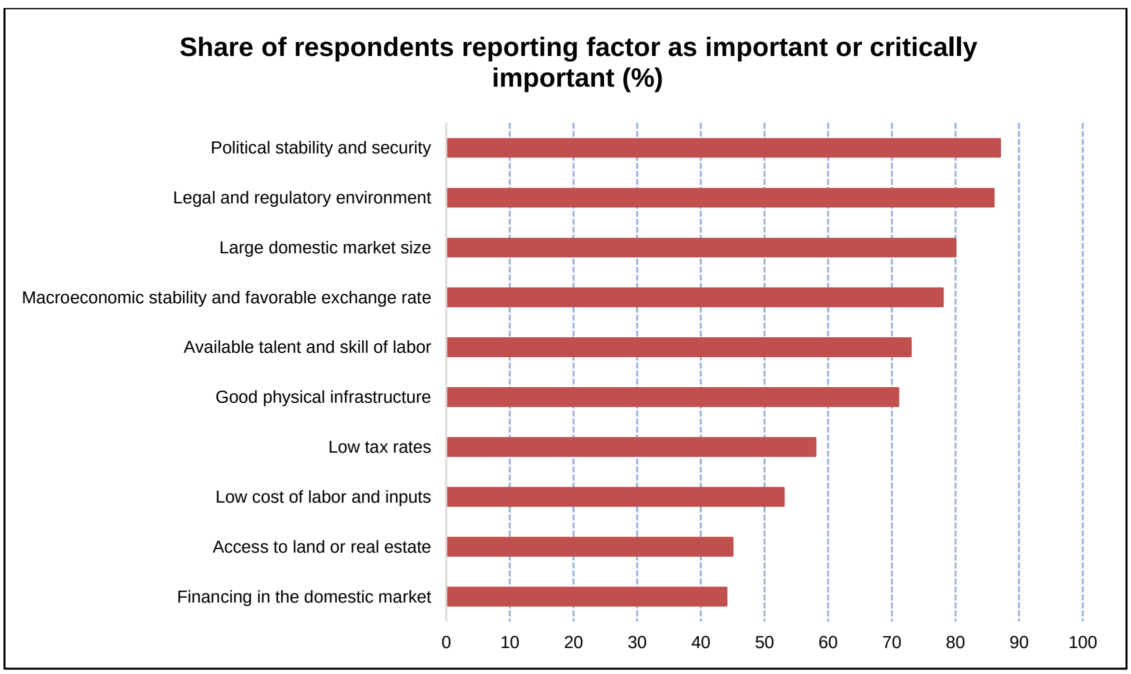

Figure 1: Importance of different factors of investment environment

Source: Global Investment Competitiveness Report 2017/2018, based on GIC survey

The main criteria that investors consider include:

- A predictable and non-discriminatory regulatory environment, with minimal administrative impediments to business.

- A stable macroeconomic environment, including market size and scope for international trade, including bilateral agreements and treaties
- Sufficient and accessible raw material and skilled labour, with relevant infrastructure and human capital

Foreign investors typically follow a two-stage process in deciding their investment location. At the first stage, countries are screened on the basis of the fundamentals describe above. The short-listed countries can then be screened according to tax rates, grants and other incentives. Surveys undertaken in several countries show that the large majority of investors surveyed in several countries would have invested even if the incentives were not provided, and on average just 16% of the investors said that investment incentives influenced their decision.

This discussion suggests that the highest priority reforms for attracting investment are in undertaking lpolicy, institutional and regulatory reforms that help create a facilitative investment climate. While investment incentives might help offset some disadvantages, they cannot substitute for market fundamentals, and neither can they be successful if the market fundamentals are not attractive.

3.2. SECTOR IDENTIFICATION CRITERIA

This section describes a two-step process for sector identification and incentive design that can inform sector selection by Government of KP. The first step evaluates the benefits of the sector, and the second step designs tailored incentives in proportion to these benefits, and such that they ensure that the benefits are realized.

However, as discussed earlier, sector selection is not recommended at the provincial level for two related reasons. Firstly, priority sectors already have comprehensive federal sector specific policy documents such as for the auto sector, textile sector, IT sector etc. Many of the sector specific issues such as standards and trade tariffs are in the federal domain, and therefore there is limited scope for policies at the provincial level. Secondly, it is a very substantial task to comprehensively determine the right sectors to support, which themselves can change subject to the external environment and therefore the exercise needs to be repeated regularly. It is, instead, more efficient to avoid duplication and focus on activity-based incentives (for example, for research and development, labour skills and supply chain improvements) at the provincial level rather than identify sector specific support:

Nevertheless, if sectors are to be supported at the provincial level even through sector-speciifc policies, the target sectors must have demonstrable spillover benefits in order to justify government intervention. For example, if a sector has strong economic and innovation benefits e.g. value chain development, that are likely to be accessible to a wide section of the labor, without major environmental problems, then the Government can offer specific incentives to support the sector, and the benefits from the additional boost to the economy may well more than compensate for the cost.

Sectors to support can be evaluated for benefits via economic impact (including innovation and sustainability), impact on social inclusiveness and environmental sustainability. These factors are outlined below.

***Economic Factors* –** Economic factors should be the most important consideration to assess the attractiveness of various sectors and design any incentives for preferable investments. The following questions should help determine the economic impact of an industry or investment type:

1. Potential domestic market size
2. Will growth in this sector have a significant impact on balance of trade?
    a. What is the scope for export promotion?
    b. What is the scope for import substitution?
3. Will growth in this sector have a significant impact on competitiveness of other sectors?
    a. Does it produce an input for another good?
    b. Will it reduce market concentration and/ or prices and increase choice?
    c. Is it an enabling sector or an enabling technology?
    d. What integration opportunities are there for local businesses?
4. Are there good investor prospects in this sector?
5. Does KP have the underlying assets and natural resources to be competitive in this sector?
6. Can KP develop the infrastructure to compete in this sector? Are the barriers to growth in this sector easy to remove?

***Innovation* –** Innovation and technology readiness are linked intrinsically to both economic benefit and social inclusiveness. Innovation contributes to higher valued jobs and to sustained economic growth, both of which are crucial determinants of economic benefit and quality of employment.
The following questions should help determine the impact of an industry or investment type on promoting innovation:

1. How much R&D is undertaken in the industry globally?
2. What proportion of skilled personnel and R&D workers are hired globally?
3. How many patents does the industry file globally?
4. What are the prospects for KP for acquiring technology?

***Social Inclusiveness* –** Social factors should cover the expected benefits to be reaped by local SMEs and workforce, skill readiness to enable local workforce especially women and other marginalized groups to derive maximum benefit and opportunities to upgrade and develop skills and any other poverty reduction effects. These should also cater for any geographical disparities. The following questions should help determine the impact of an industry or investment type on social inclusiveness:

1. What is the expected impact on the quantity of jobs?
    a. Scale of investment
    b. Employment multipliers
    c. Labor intensity of production
2. What is the expected impact on the quality of jobs?
    a. Typical composition of higher value addition, permanent jobs
    b. Proportions of different grades of labor expected to be used – management, high skill, low skill
3. Are there prospects for improving gender inclusiveness?
4. Are there prospects for improving geographical disparities within KP?
5. Provision for SMEs
6. Skills and resource match with current population profile

***Sustainability* –** There are three types of sustainability: economic sustainability, social sustainability and environmental sustainability. Since social and economic sustainability is covered above, this section focuses on environmental factors.
The following questions should help determine the environmental impact of an industry or investment type:

1. Economic sustainability: how does it contribute to growth that is high, non-volatile and long-lasting enough to be meaningful
2. Social sustainability: covered under Social inclusiveness
3. Environmental sustainability in production process and product use
    a. Energy and material efficiency
    b. Resource depletion
    c. Effluent damage
    d. What are the safeguards available in current environmental policy to contain this?
    e. Does government have the capacity to make the required rules and/ or implement existing rules practically?
    f. Is the investment likely to improve energy efficiency in the future?

3.3. Design Principles for Investment Incentives

In designing investment incentives, it is important to understand the larger context of an investor's decision making. While investment incentives are sometimes used to compensate foreign investors for a compromised investment climate and/or to match incentives provided by other countries or provinces, they are not amongst the main reasons investors report for their location decision. The main reasons for choosing an investment location have to do with market fundamentals such as market size, access and prices of raw materials and labor and the business environment. Recent surveys of investors on the factors that determine their investment decision show that the primary determining factor is an attractive enabling environment. This includes:

- A predictable and non-discriminatory regulatory environment, with minimal administrative impediments to business.
- A stable macroeconomic environment, including market size and scope for international trade, including bilateral agreements and treaties
- Sufficient and accessible raw material and skilled labor, with relevant infrastructure and human capital

Only countries that meet these criteria are then screened for tax rates, grants and other incentives.[1] Therefore it is more effective for governments to prioritize improvements in the business environment over investment incentives, as such improvements impact all firms - large and small, foreign and domestic alike - and enhance investment across the board.

Furthermore, evaluations of investment incentives across countries find that they have a tendency to be inefficient and promote rent seeking, and that they may never realize the benefits that they set out to achieve. Research on the experiences of other countries also suggests that that the final impact of incentives depends on the design of incentives. Good design features include:

- Good governance
    - Transparent, rule-based and simple procedures
    - Stable, time-limited incentives
- Performance-based and subject to evaluation
- Harmonized with federal incentives and coordinated with other provinces
- Non-discriminatory
- Back-loaded (i.e. paid out over a period of time *after* investment targets are met, rather than paid up-front before investment targets are met)

3.4. OVERALL VALUE PROPOSITION

A meaningful investment policy must result in investment generation for the province and therefore must be based on some underlying thinking, diagnostics and some concrete policy actions. Merely basing the proposition on fiscal investment incentives may be counter productive, as it will create mutually detrimental competition with other provinces. Ideally, the provincial incentives should be at par with each other, with some differences due to different contexts. Therefore, the investment policy should take into account comparative advantages of KP and must capitalize on them.

For instance, consistent and continuous gas supply to industries is a critical pre-requisite for many of them to operate profitably and sustainably. Khyber Pakhtunkhwa, being a producer of natural gas enjoys preferred supply of gas, which is its natural endowment. Article 158 of Constitution of Islamic Republic of Pakistan states that “the Province in which a well-head of

[1] World Bank Global Investment Report 2017-18

natural gas is situated shall have precedence over other parts of Pakistan in meeting the requirements from that well-head, subject to the commitments and obligations as on the commencing day.” The High Court has also upheld the right of the province to enjoy the first right over the gas produced in their province and directed the Sui Northern Gas Pipelines Ltd (SNGPL) to ensure uninterrupted supply of gas to the consumers of the province from the well-heads situated in the province. This was also followed by KP’s demand for increased gas supply, which was approved by NEC. However, in recent years, KP’s gas consumption has increased while the federal government recently cut down the gas production in KP by 80 million cubic feet per day (MMCFD). Consequently, last year, KP’s share in gas production was 7%, while claiming 10% in consumption. This however can change. According to KP Oil and Gas Company Limited KP has a recoverable potential of 16 trillion cubic feet of gas, which could add exponentially to gas supply for KP. This advantage for KP could be used in the investment policy, by guaranteeing uninterrupted gas supply at prefential rates.

3.5. Institutional, Regulatory and Policy Reforms

Any investment policy will only be as good as the capability of the government to deliver it. Institutional, regulatory and policy reforms therefore form an important part of the overall investment policy framework. Following are some of the areas that must be covered as part of KP’s investment policy:

Investment promotion, facilitation and aftercare – It is important to differentiate between investment promotion and facilitation. In all provinces, the focus of investment promotion agencies (IPAs) is more on the former, due to little or no influence with regulators that could help in facilitation. At best they serve as initial starting point for investor-state interface but the investors eventually have to chase individual government agencies to sort their issues out. The policy should clearly specify the government’s focus on investor facilitation and should be accompanied with some serious capacity on ground. Within the area of investor facilitation, the idea of one window has gained a lot of popularity in Pakistan, but as explained these are merely communication hubs and nothing more. The policy should ideally put forward a plan for effective functioning of such interfaces, which could only happen through delegation (in selected areas) to these units.

A second area of concern is investor aftercare, which has taken priority on agendas of IPAs around the world. This aspect however is still non-existent in Pakistan and the policy should cover that.

Pre-approvals and negative lists - There are several international examples that can be replicated such as pre-approvals and use of negative lists to facilitate investors, which could also form part of investment policy (at least in terms of their need). For instance, the government should clearly indicate ‘encouraged’ and ‘restricted’ or ‘prohibited’ categories, thereby promoting foreign/domestic investment in certain industries while limiting or altogether prohibiting in others. The federal government already defines both sets of factors. For example, arms and ammunitions, high explosives, radioactive substances, securities, currency, mint and consumable alcohol are restricted industries.

The ones not falling under the last two categories should have some declaratory automatic approvals. Such classification can then help the government in introducing different levels of approval scrutiny or tougher application requirements for prospective investors only in selected sectors rather than creating bureaucratic hurdles for all investors. Similarly, special incentives can be announced for priority industries (identified through appropriate diagnostics).

Business Enabling Environment – The draft policy does mention Cost of Doing Business but in vague terms. The creation of a business-enabling environment should be a top priority for the Givernment of KP in order to attract investment. For, example, World Bank's Doing Business survey is carried out in both Lahore and Karachi and consequently both Punjab and Sindh have initiated Doing Business reforms to improve the overall experience of the investors and reduce the cost of doing business in the two provinces (and more so in the two cities). There is no similar effort underway in KP. The last sub-national Doing Business Survey was carried out in 2010 in Pakistan and Peshawar was ranked 8th amongst 13 cities of Pakistan. Peshawar's ranking however was better than both Karachi and Rawalpindi. The study ranked these cities on six criteria including starting a business, construction permits, registering property, paying taxes, trading across borders, and enforcing contracts. Apart from the first two, Peshawar was ranked quite low on all the other dimensions. There is a need to benchmark major KP cities on doing business indictors, which should then inform the reform efforts.

Contract enforcement - One of the major obstacles faced by investors is contract enforcement and prolonged (and often ineffective) litigation for settling disputes. Therefore, the investment policy should also focus on alternative dispute resolution mechanisms, including arbitration, mediation and conciliation for resolving commercial disputes. Furthermore, if disputes are resolved through arbitration outside the country or province, there is a need to ensure that courts in KP recognize and enforce these decisions in accordance with applicable international standards.

The draft policy does provide an investor grievance redressal mechanism to address investors' issues with the government but this mechanism needs to be strengthened.

3.6. Transparency, Predictability & Consistency

The investment policy should commit to clear and transparent implementation and enforcement of laws and regulations and should cover transparency in procedural issues as well. Such transparency will especially be critical in public procurement, public-private partnership transactions, mining concessions, etc. The government should also make sure that laws and regulations do not impose an unnecessary burden on investors and the investment policy can potentially institute a practice of measuring and quantifying these burdens as well as introduce a built-in mechanism to periodically review them. Similarly, the investment policy can only be meaningful, if it ensures sufficient degree of policy predictability for investors including areas such as regulations, taxes, etc.

It is not essential that present regulations or taxation should be locked but the policy can very well give a direction for them to move so that investors can build them in their business planning and scenario analyses. The policy can also introduce a review process for administrative decisions as well as some mechanisms to manage and co-ordinate regulatory policy across different levels of government to ensure consistency and a transparent application of regulations. The investment policy may cover government's commitment for developing registers of existing and proposed regulations, ensuring use of electronic dissemination of regulatory material and publishing administrative decisions and other relevant data, embracing open government principles.

These mechanisms for transparency, predictability and consistency should be based on effective public consultation mechanisms and procedures, including prior notification requirements, before enacting new laws and regulations and ensuring that government is fully informed of the investors' concerns.

3.7. INVESTMENT LAW

The draft policy mentions that KP government is considering promulgating KP Investment Law. The question of an investment law should be fully thought through if this is to be introduced in the investment policy and it should be broadly mentioned what it would cover. Many countries that have had significant success in attracting investment do not have such laws, as some elements of an investment law can be better addressed in other legislation such as the Constitution, companies regulations, tax laws or sector-specific legislation. An investment law, if not carefully developed, can also lead to inconsistencies with other laws. On the upside, an investment law to support the policy can cover property protection guarantees for investors, set the degree of openness to investment and the rules for market entry and encompass sectors classification as well as the allied regulations and incentives. However, it is also important to look on how such law will work with the already present Foreign Private Investment (Promotion & Protection) Act, 1976 at the federal level.

3.8. INFRASTRUCTURE

China Pakistan Economic Corridor (CPEC) has brought in new prospects for investments in all provinces, however the process of transforming the transit or transport corridor into a real economic corridor would need appropriate measures by the government. The investment policy must take the CPEC-related developments into account and throw light on how increased connectivity is being complemented through the development of new areas, priority industrial estates, special incentives for under-developed or priority geographical zones, etc. Besides the priority industrial estates (and economic zones) of Rashakai and Hattar, the investment policy should also cover other industrial estates in the province. Khyber Pakhtunkhwa Economic Zones Development and Management Company for instance mentions industrial estates in

Nowshera, Hayatabad (Peshawar) and Swabi (Gadoon) and export processing zone at Risalpur. Some of these were traditionally managed by SDA, but the list does not include Jalozai and Ghazi industrial estates managed by SDA. In addition, there are also 10 or so small industrial estates managed by SIDB.

3.9. ALIGNMENT WITH INDUSTRIAL POLICY 2016

Khyber Pakhtunkhwa government already has an approved industrial policy in place since 2016, offering a number of incentives for investors. It must be clarified, how the investment policy will be aligned with the industrial policy. For instance, the industrial policy already covers the following provincial incentives (with the first two only offered till 2017 for ‘early birds’):

- 5% markup on financing for 5 years for new/expansion projects
- 25% of the cost of the plot acquired to set up industrial units.
- 25% of the transportation cost (from Karachi to industrial site) for plant and equipment for new units
- 25% of the electricity bill for 3 years for new innovative units
- 25% of equity investments for women entrepreneurs up to PKR 3 million

4. CONTOURS OF INVESTMENT POLICY FRAMEWORK

SMEA is providing technical assistance to Government of Punjab for formulation of its investment policy. The ongoing work takes into account many such issues. Following are some of the elements covered in that work, which can help Government of KP in improving the present draft policy:

1. The need for a provincial investment policy
    a. Low levels of domestic and foreign investment, which seriously compromise provincial targets set in the provincial Growth Strategy
    b. Increased levers following devolution
    c. New investment surge via CPEC
    d. Need to Focus on SMEs

2. Investment Impediments and Constraints
    a. Competitiveness, Investment Climate and Business Environment, with a specific focus on SME issues
    b. FDI Flows to Pakistan – Key Trends
    c. Investors’ Perspective – Why and Why Not? (Based on consultations with foreign and local investors especially SMEs)

3. Policy, legal and Institutional Snapshot for Investment promotion, facilitation and business environment
    a. Review of National and Provincial Investment Policies vis-à-vis international best practices; Rapid review of other provincial policies (ICT, Agriculture, Industries); International best practices of promoting green investments; Review of investment incentives
    b. Regulatory/Legal Review
    c. Institutional Mapping and Rapid Review of Their Capacity at Provincial Level – Industries Department; Punjab Board of Investment and Trade; PIEDMC; FIEDMC; ICRU; Ease of Doing Business Project; Other relevant agencies

4. Key Recommendations
    a. Proposed Framework for investment promotion - Short-term versus long-term measures; Federal versus provincial domains
    b. Provincial Investment Policy – Contours and Design
    c. Provincial policy, regulatory and institutional (including capacity building) reform package for investment promotion
    d. Communication & advocacy pack for federal policy, institutional and regulatory levers
    e. Investment climate reform agenda for Punjab

5. Way Forward
    a. Next Steps
    b. Further Diagnostics
    c. Need for a communications strategy (proposed outline)
    d. Conclusion

5. CONCLUSION

The draft investment policy by KP provides a very good starting point to develop a robust investment policy framework in the province. However such policy should be aligned with existing policies and should be based on addressing the impediments identified through appropriate diagnostics. Moreover, a policy can only be effective if it is corresponded with sufficient implementation capability. This note provides a few areas that can be worked on to improve the draft policy before it is approved. The government however must realize that approval of such a policy will be the first step in a very long journey towards creating an enabling environment for domestic and foreign investors.

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7. ANNEXURE

ANNEX-1: SOW OF THE ASSIGNMENT

Chemonics International Inc.
USAID Small & Medium Enterprise Activity

Review of Investment Policy for Khyber Pakhtunkhwa

SOW # C1BEE4

Scope of Work Summary:

With an increased focus of Government on boosting investments within Pakistan, specifically in light of the ongoing China Pakistan Economic Corridor initiative, it is not only important but also necessary for provinces to identify key impediments that are impeding foreign and local investment and take measures to address those hurdles. In light of this significance, the Government of KP has recently developed an Investment Policy for the province. This assignment will focus on reviewing the Investment Policy, identifying gaps and making recommendations for improvement, with a special focus on SMEs.

1. Position Title & Department:

Short Term Technical Experts, Business Enabling Environment Component.
The proposed team composition for this assignment will include the following;

- Institutional Expert
- Economist

2. General Summary:

Chemonics International is implementing Pakistan Small and Medium Enterprise Activity (SMEA), which is a 5-year, $35 million project that is aimed at improvement of financial and operating performance of small and medium enterprises (SMEs) in Pakistan in selected high-performing industrial, manufacturing and services sectors.

Creating an enabling business environment is one of the core work streams of this project. As such, the Project engaged with the Government of Khyber Pakhtunkhwa and the Government of Punjab to identify key areas of collaboration. The Government of Khyber Pakhtunkhwa has already drafted an Investment Policy for the Province and it has requested SMEA to review the policy and provide recommendations for improvement.

Investment is central to economic growth, driving job creation and boosting an economy's productive capacity and income growth. International investment in particular is also useful as a source of technology transfer. Yet, net inflows of FDI in Pakistan have declined steadily over the last ten years. Measured as a percentage of GDP, FDI is now well below the average for both South Asia and for lower-middle income countries.

The investment expected under the ongoing China Pakistan Economic Corridor initiative should contribute towards reversing that trend. However, it will be important to have in place a good investment policy framework to ensure that investments that promote economic growth, technology transfer and domestic employment are encouraged, but that negative spillovers such as environmental degradation are kept at bay.

This requires building a competitive environment for investment, an enabling regulatory structure, and an attractive set of incentives. This can be done through several integrated policy arms including investment policy, investment promotion and facilitation, trade policy, competition policy, tax policy, public governance and financing for investment. The assignment will focus on providing advice on the policy arms and levers that are in the domain of the Government of Punjab. Additionally, the focus of the assignment is on facilitating investment in the SME sector especially by mobilizing domestic investors.

The recommendations will support and be informed by KP's objectives and priorities, as specified in the KP Integrated Growth Strategy 2014-2018. This analysis based on KP's strengths and constraints will be complementary to Federal investment policy.

3. Objective of the Consultancy:

Objective:
To review the Investment Policy for Khyber Pakhtunkhwa and identify gaps (if any) and provide recommendations for improvement in light of the policy, regulatory and institutional arrangements, with a special focus on SMEs

The purpose of this assignment is;

- To review the Investment Policy recently drafted by the Government of KP and provide recommendations for improvement.

4. Principal Duties & Responsibilities:

- To review the Investment Policy drafted by the Government of KP.
- Hold meetings (as needed) with key public and private sector players in KP regarding investment promotion opportunities, issues & challenges, specifically focusing on SMEs.
- To analyze and recommend investment initiative for Pakistani diaspora.
- To analyze and identify improvements through investment policy revisions wherever necessary and areas of legislative, regulatory and/or institutional reform required for a more efficient mechanism of policy implementation
- To propose measures of promoting investments including incentives structure, if any.

- *Note: A list of relevant reading material required for the assignment is attached as Annex B.*

5. Specific Tasks of the Consultants:

The purpose of this assignment is to identify key impediments to investments in KP and undertake assessment of the existing investment policy framework and provide recommendations. The consultants will also benchmark the existing investment policies with those of major competitor economies by sector and/or region and provide best practice guidelines for sustainable investment policy formulation.

Specific tasks required are:

- A comprehensive review and assessment of the investment policies of KP, including applicable national investment policies.
- An objective evaluation and advisory review of the regulatory framework for investment.
- A review of KP's institutional framework for investment, to ensure consistency of policies, procedures and the identification of policy gaps;
- Draft a final report that documents the findings and make recommendations.

6. 6. Job Qualifications

Advisor	Person Specifications	TOTAL Level of Effort
Institutional Expert	• Masters degree in Public Policy, Law, Public Administration from a reputed international university • At least 10 years of experience working in development issues • Deep knowledge and understanding of the national, provincial, local regulatory, legal and policy environment pertaining to the SMEs • A sound understanding of issues related to the role investment plays in the economy, particularly is a developing country context • Knowledge of investment policies in Pakistan and Punjab, as well as best practice • Previous experience of working with USAID projects in the area of economic growth will be preferred • Experience of working with donor projects in the SME space • Excellent communication and report writing skills	7 days
Economist	• Masters degree in Business, Economics, Management, Public Policy from a reputed international university • At least 5 years of experience in undertaking research on industrial development in Pakistan • Good understanding of the current business environment, macro-economic framework and the corresponding institutional arrangements at the federal and provincial levels • Deep understanding of the investment climate in Pakistan and Punjab and of the investment policies and incentives • Good understanding of the constraints faced by the SMEs at the federal and provincial levels • Previous experience of working with USAID projects in the area of economic growth will be preferred	7 days

Advisor	Person Specifications	TOTAL Level of Effort
	• Experience of working with donor projects in the SME space • Excellent communication and report writing skills	

7. Duty Station:

The consultants will be based in Islamabad/Peshawar and will be working closely with the BEE team

8. Workspace and Use of Personal Laptop and Software(s):

The consultant will be required to use his own personal laptop and must certify that all software used are genuine and licensed; to ensure that the project's IT resources are protected from accidental destruction or deliberate attempts at sabotage by computer viruses and other hazards.

9. Reporting:

The work of the consultants will be supervised by the Senior Policy Advisor along with the BEE team. The consultants will be required to report to the Senior Policy Advisor and/or his designee.

10. Duration of the Assignment:

This job is planned to take place as per a start date of on or around 03/28/18 and end date of on or around 04/30/18 (subject to date of mobilization) hereto for a total of 7 days LOE each (for institutional expert and legal expert) including 3 travel days if needed. The TOTAL LOE will be spread over a month.

11. Deliverables:

The following are the key deliverables and their associated deadlines. ***The final deliverable of this assignment is the Review Report***. The timeline for the LOE assigned for each activity as mentioned in the following table will be discussed and agreed with the technical team and the consultant.

No.	Activity	LOE (Days)
1	**Interview and meet with the Senior Policy Advisor & BEE Team to understand the scope of the assignment.**	**1**
2	**Meetings and discussion with relevant Government Departments in KP to develop institutional understanding**	**3**
3	**Preliminary Findings**	**1**

No.	Activity	LOE (Days)
4	**Regulatory Review**	**Within 1st week**
6	**Review Report**	**April 25, 2018**

Note: A final report template outline has been provided as Annex A.

ANNEX -2: BACKGROUND READING MATERIAL

The Consultant(s) shall read, but are not limited to, the following materials to fully understand the work specified under this Consultancy:

a. BEE Analysis Study including situation analysis and diagnostic framework.

b. Board of Investment, Investment Policy
http://investmentpolicyhub.unctad.org/ipfsd
http://investmentpolicyhub.unctad.org/Publications/Details/148
http://www.boi.gov.pk/UploadedDocs/Downloads/InvestmentGuide.pdf
http://www.commerce.gov.pk/wp-content/uploads/2016/03/STPF-2015-18-Document.pdf

http://www.oecd.org/investment/investment-policy/36671400.pdf

c. Ministry of Commerce, Strategic Trade Policy Framework 2015-18

d. Organization for Economic Co-operation & Development, Policy Framework for Investment.

e. Provincial Investment Policy, Government of Khyber Pakhtunkhwa

f. SMEA Market-Led Sector Analysis
g. SMEA Sector Briefs
h. SMEA Work Plan, Year 2.

i. Summary Preliminary findings of the Investment Policy Framework being developed by SMEA for Punjab.
j. United Nations Conference on Trade & Development (UNCTAD), Global Action Menu for Investment Facilitation
k. United Nations Conference on Trade & Development (UNCTAD), Investment Policy Hub

USAID Small and Medium Enterprise Activity
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