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# Toward a Greater Understanding of Business Constraints in Pakistan

**Session 3.3 Focusing Reform Efforts**

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# Country Profile


## PAKISTAN FACTS (2005)

Population: **152.53 Million**

Capital: **Islamabad**

Monetary unit: **Pakistani Rupee (Rs. 60 ≈ US$1)**

Life expectancy: **63 years (men), 65 years (women)**

Country GDP: **US $112 Billion**

GDP per Capital: **US $736**

Exports: **US$ 14.41 Billion**

Imports: : **US$ 20.62 Billion**

Economic Growth Rate: **8.4%**

Contribution by Sector: **Industry(25%) Agriculture (24%) Services (51%)**

# Sub-National Business Environment Reforms

- Firms are Heterogeneous Economic Units
- Constraints in Business Environment vary by firm characteristics
- **Firm Characteristics:** Firm size, Region, Access to export markets, Manufacturing Sub-sector, Firm age, and Type of ownership
- **Reforms can be more meaningful if these variations are taken into account**
- We study the relationship between firm characteristics and the degree of business constraints reported by firms using regression analysis
- Investment Climate Assessment Survey of Pakistan provides a rich data set for this study

# Summary of Constraints by Severity

**(Percentage of firms ranking constraint as “major” or “very severe”)**

| Constraint | Severity |
|---|---|
| ***Tax administration*** | **47%** |
| ***Tax rates*** | **47%** |
| ***Financing Costs (interest rates)*** | **43%** |
| ***Economic Policy Uncertainty*** | **40%** |
| ***Corruption*** | **40%** |
| ***Electricity*** | **39%** |
| ***Access to Financing (collateral)*** | **38%** |
| ***Macroeconomic instability*** | **35%** |
| Customs & Trade regulation | **24%** |
| Anti-competitive Practices | **21%** |
| Crime, theft and disorder | **21%** |
| Access to Land | **21%** |
| Labor Regulations | **16%** |
| Business Permits | **15%** |
| Skills & Education of workers | **13%** |
| Transportation | **10%** |
| Telecommunications | **8%** |

# Firm Size - Does Size Matter ?

- Taxation, Electricity, Access to Financing are *Binding Constraints* in firm growth
- Micro firms - Financing and Economic policy uncertainty are binding constraints. Taxation, electricity not binding
- Access to finance is a major issue for small firms
- Taxation and Electricity problems are biggest for medium
- Large firms devote more resources for dealing with taxation issues, Small firms are most burdened as %age of sales
- For SME sector, areas for intervention are:
  - Taxation: Rates and general administration have to be reviewed
  - Improvement in the provision of electricity
  - Expansion of formal financing for smaller firms
- *Improvements in other areas would benefit larger enterprises*

# Regional location of the Firm

- Sindh and NWFP less conducive than Punjab and Balochistan
- Regional location matters most for cost & access to financing and for electricity
- Costs and access to financing is major issue in Sindh
- NWFP experiences the biggest problems with electricity, followed by Sindh and Punjab
- Non-binding constraints:
  - Customs and trade regulations are less of problem in Balochistan and Punjab
  - Access to land is a bigger problem in Sindh
  - Crime, Business permits, and Worker skills – Balochistan

# Access to Export Markets

- Exporting firms overwhelmingly have fewer complaints
- Exporters enjoy special incentive packages in taxation and financing
- Exporting firms pay tax at a rate ranging between 0.75 – 1.25% of sales
- Central Bank allows exporters access to export refinancing funds, at concessional rates
- Corruption, Policy & Regulatory uncertainty are non-issues
- Only constraint identified as binding by exporting firms is electricity

# Manufacturing Sub-sectors

- Seven Sub-sectors: Textiles, garments, leather goods, food processing, electronics, chemicals, and sports goods
- Sports goods, leather goods, and electronics - better off than the textiles, garments, chemicals and food processing industries
- Sports goods and leather goods industries do not experience any binding constraints
- Meanwhile, the food processing industry complains most loudly - the responses from textiles, garments, and chemicals are close
- Results point to improving investment conditions for textiles, garments, chemicals and food processing industries

# Firm Age

- Firm age is not an important factor
- Two constraints with differential responses by age are tax administration and macroeconomic instability
- Tax administration: Constraint for firms between 11 and 15 years old
- Macroeconomic Stability: Binding constraint for firms between 6 – 10 yrs old
- Conditions are severe for New Entrants – 30% die within a year

# Firm Ownership Structure

- Private limited structure is punitive
- Publicly listed companies have less complaints than even sole proprietorships
- Complaints of sole proprietorships, publicly listed companies, and partnerships are generally not statistically distinguishable
- Privately held companies spend more days dealing with regulators and pay more to government regulators in terms of fines and bribes
- Pakistan does not offer any incentives to corporate entities in terms of tax administration, tax rates, interest rates, access to finance
- Sole proprietary concerns can easily escape from regulators' radar without losing any advantages

# Conclusions

- *Current Reform in taxation, power and banking sectors may not improve BE for SMEs*
- **Business Environment can not improve unless we customize solutions**
- **Idiosyncratic characteristics of each economic region must be taken into account**
- **There is need for systematic analysis, rather than working just with perceptions**
- **Must expand the capacity of policy making institutions**

# Final thoughts

- Currently, a new Investment Climate Survey is being conducted by SMEDA and the World Bank in Pakistan, which will show how conditions in 2006 compare and contrast to several years earlier.
- Evaluation tools such as ICA or DBS  must have the flexibility to capture the real issues of each local situation
- Donors support for promoting sector and regional development and articulating important policy issues is pivotal.