Industrial Structure of Pakistan

I. Introduction

Pakistan's economy may be characterized as standing at a semi-industrialized stage of development. The industrial sector accounts for about 24% of GDP.

Province of Punjab and Karachi, District of Sindh Province constitute the backbone of the country's industrial setup. According to the most recent figures from the Economic Survey of Pakistan, released every year before the Federal Budget, the country's industrial sector presently constitutes roughly 25% of the country's gross domestic product. Output in the manufacturing sector witnessed expansion of 3% in FY11 as compared to expansion of 5.5% in FY10 on the back of strong performance from both the small and medium manufacturing sectors.

On the other hand, the most prominent large scale industries of Pakistan are textile, cement, food and beverages, petroleum, steel, non-metallic minerals, automobiles, fertilizer, pharmaceuticals, paper, electronics, steel, chemicals, leather, wood, engineering and rubber. During FY11, the production by the Large Scale Manufacturing (LSM) sector increased by 1.71%, which was mainly caused by an improvement in sub groups of leather (30%), automobile (14.6%), food, beverages and tobacco (9.3%) and paper and paperboard (2.9%). The items which demonstrated an increase in their production during this period were TV sets (28.6%), sugar (26.5%), LCVs (23.3%) and cooking oil (9.7%). On the other hand, cement production decreased to 20.8 million tons as against 23.1 million tons last year showing a decrease of 9.6%.

In particular, it would be useful to talk about Pakistan's textile sector. As Pakistan is one of the major producers of cotton, the country has a sound textile industry. Cotton textile production and apparel manufacturing are Pakistan's largest industries, accounting for about 55% of the merchandise exports and almost 40% of the employed labour force. Cotton and cotton-based products account for 61% of export earnings of Pakistan. The export earnings of textile products in FY11 showed an increase of 29.9% this year over last year.

Pakistan during the last couple of years has also made huge strides in other industries. Some of these include automobiles, fertilizers, pharmaceuticals, and cement. All of these have emerged as strong performers in the export market, which is very encouraging.

II. Foreign Investment Environment in Pakistan

The World Bank classified Pakistan at the 105th rank in Ease of Doing Business Index, and at the 90th rank in Ease of Starting a Business in the World Index, in its annual 'Doing Business' Report for 2011. Some of the top reasons why Pakistan is a good destination for investment are:

a. Returns of capital up to 50%
b. Cheap labour
c. Availability of liquidity
d. Expanding infrastructure
e. Security of investment: even during nationalization of 1970s no foreign or MNC was nationalized.

The Board of Investment offers 5 main reasons to invest in Pakistan:

1. Geo-strategic Location

Located in the heart of Asia, Pakistan is the gateway to the energy rich Central Asian States, the financially liquid Gulf States and the economically advanced Far Eastern tigers. This strategic advantage alone makes Pakistan a marketplace teeming with possibilities.

2. Trained Workforce

A large part of the workforce is proficient in English, hardworking and intelligent. Pakistan possesses a large pool of trained and experienced engineers, bankers, lawyers and other professionals with many having substantial international experience.

3. Economic Outlook

Today Pakistan has almost 180 million consumers with an ever growing middle class. Foreign Direct investment has risen sharply from an average of $300 million in the 1990s to over $3.7

billion in 2008-09. And FOREX reserves have increased from $3.22 billion in 2000-01 to $11.6 billion in June 2009.

4. Investment Policies

Current investment policies have been tailor-made to suit investor needs. Pakistan's policy trends have been consistent, with liberalization, de-regulation, privatisation, and facilitation being its foremost cornerstones.

5. Financial Markets

Financial market reforms have resulted in the development of improved infrastructure in the stock exchanges of the country. The Securities and Exchange Commission of Pakistan has improved the regulatory environment of the stock exchanges, corporate bond market and the leasing sector. On the other hand, the Federal Board of Revenue has facilitated structural reform in tax and tariffs and the State Bank of Pakistan has invigorated the banking sector into high returns on investment.

III. Potential Sectors for Attracting Foreign Investment

1. Oil & Gas Sector

There are numerous reasons why Pakistan's oil and gas sector presents numerous opportunities for investment to both local and foreign investors. Some of these include the realities that Pakistan is the world's seventh most populous nation, one of the largest economies of the world in need of energy, the second largest offshore basin of the world, largely unexplored territory located next to one of the largest reservoirs of oil and gas in the world, and has an aggressive and focused Exploration and Production Policy.

According to the Board of Investment, Pakistan has so far discovered 1 billion barrels of oil and 54 trillion cubic feet of natural gas. It has a sedimentary area of 827,000 Sq. Km out of which 1/3rd is under exploration and 2/3rd has yet to be explored for aggressive exploration for oil and gas.

Currently, 17 major multinational E&P companies are operating in Pakistan. The country has an energy hungry market which can immediately accept 2 bcfd gas and over 300,000 bpd oil. The government of Pakistan offers some of the best terms and conditions to E&P sector through the new petroleum policy 2009 and tight gas policy 2011.

2. Information technology

Pakistan provides numerous possibilities for investors in the IT sector. The Government of Pakistan has provided a number of incentives that have been instrumental in the IT industry's development. As a result, an increasing number of foreign IT companies have chosen Pakistan for their outsourcing operations. According to the Board of Investment, these incentives include financial assistance with meeting certification requirements, permission to own 100% equity for foreign IT/ITeS companies, tax exemption for IT companies till 2016, permission to repatriate 100% of profits, and a minimum rate of 30% depreciation on computer equipment. The Government as the main facilitator, enabler, and promoter of the IT sector, has evolved an effective national IT Policy and Action Plan that clearly caters to the needs of nurturing the industry and is responsive to the dynamic forces of change that can affect its future growth. The Private Sector is being brought into the mainstream as the main driver for growth.

3. Energy Sector

The conventional opportunities for the energy sector in Pakistan would involve hydel, thermal, and coal projects. In view of the energy crisis being faced by the country, these are certainly worth exploring, and would certainly be lucrative investments.

At the same time, there is much room for exploring the field of alternative energy. According to the Board of Investment, there are various reasons why Pakistan is an attractive destination for investors seeking to invest in alternative energy. These include an extremely attractive/investor-friendly Renewable Energy Policy, which features wind risk coverage, buyback guarantees, liberal political risk coverage, liberal financial incentives, and a very lucrative IRR. There is also facilitation for the procurement/lease of land for wind farms provided by the Alternative Energy Development Board (AEDB), which is unheard of in other territories around the world. Then, there are extremely cheap rates offered for land for wind farms. All environmental issues are dealt with by AEDB on behalf of investors. There is also the provision of an attractive tariff and availability of infrastructure for setting up manufacturing facilities.

4. Sugar Mills

Sugar Mills have a natural advantage of fuel (bagasse) availability to venture into power generation business. Many of the sugar mills are already producing power for self consumption. The Government of Pakistan has announced a lucrative Co-Generation Policy for sugar mills which not only extends the benefits of Power Generation Policy 2002 but also foresees availability of 'process steam' for sugar production. The Co-Gen Policy is very simple in processes and lenient in procedures. Besides help adding the value to the by-produced bagasse as fuel the Co-Gen Policy allows coal utilization to fill-gap the fuel needs.

IV. Primary Industrial Sector

Three of the primary industrial sectors of Pakistan; Steel, Chemicals and Fertilizers are important not only in terms of employment and revenue generation, but also as significant contributors in supporting the competitiveness of the value added Industry. All value added industry, be it textile, leather, engineering or food processing is dependent on inputs produced by these industrial sectors. To improve Pakistan's industrial competitiveness, it will have to significantly upgrade and strengthen these primary/ancillary industries.

Chemical Industry

In recent years, the global chemical industry has become one of the fastest-growing manufacturing sectors despite soaring crude oil prices and stricter international environmental protection standards. It is now well established that because of forward and backward linkages, polymer consumption has a significant multiplier effect on GDP growth. Moreover, the chemical industry is considered to be a major driver for innovation, and, developments within it have strong positive effects across industries such as auto, rubber, textiles, consumer products, agriculture, petroleum refining, pulp and paper, health services, construction and metals.

A key by-product of oil refineries is Naphtha, which when cracked further, produces Ethylene, Butadiene, Propylene, Benzene, Toluene, Paraxylene etc. for a number of downstream industries such as Textiles, Paints, Plastics, Pharmaceuticals, Agriculture, Packaging and others. Pakistan has no facility to produce basic olefins like Ethylene, Propylene, Butadiene, Styrene as well as aromatics like Benzene, Toluene and Xylene due to absence of Naphtha cracking facility. This has resulted in limited growth of chemical and petrochemical industry in the country.

At present, the petrochemical industry of Pakistan is mainly downstream and includes production of Polyvinyl Chloride (based on imported Ethylene), Synthetic Fibres (based on imported MEG), Purified Terephthalic Acid (based on imported Paraxylene), Aromatics and Carbon Black. Current demand of the petrochemical based products is around 2.0 million tons/year. For manufacturing of these products, a large quantity of basic raw material is imported e.g., Pakistan spent around $1 billion on import of these polymers in 2009.

Similarly, the chemical industry is not fulfilling domestic requirements, as a result every year a large amount of foreign exchange is also spent on the import of different chemicals. This has caused a burgeoning chemical import bill of approximately US$ 4 billion which is approximately 12 percent of total imports. Given the high demand for inputs/raw material by the domestic downstream industry there is a vast potential to manufacture petrochemicals within the country.

Lack of integration in petrochemical industry of Pakistan is hampering the growth of downstream chemical industry. For the establishment of a fully integrated industry, it is imperative to set up a naphtha cracker plant in the country which is the missing link in the value chain. Pakistan has a crude oil refining capacity of 12.81 Million Tons/Annum[50] and there are further refining projects in the pipe line which will increase this capacity in the near future. Refineries produce around 900,000 Tons/Annum of Naphtha which is being exported at a nominal price because of absence of Naphtha cracking facility in the country. Thus, a large-scale naphtha cracker in Pakistan is the need of the hour. There have been many studies conducted recently which have stressed the need for establishing such a facility. With this building block in place a large number of chemicals can be produced which include Plastics, Synthetic Rubbers, Fertilizers, Explosives, Solvents, Dyes and Pharmaceuticals. The estimated cost of this project is US $ 1.5 Billion.

Steel Industry

Steel is a critical ingredient for most intermediate and final products in an industrial economy, and it is difficult if not impossible for Pakistan's industry to become competitive without a reliable base for steel production. Pakistan has an abundance of iron ore deposits (with the largest ones located near Kalabagh (an estimated 300 million tons), Dilband (200 million tons) and Chiniot (100 million tons). Unfortunately, despite this availability, local steel production has not kept pace with increasing demand and Pakistan has become increasingly reliant on steel imports, that limits the expansion in the value added industry.

The gap between demand & supply of steel is increasing dramatically. The present gap of 1.4 million tons is projected to increase to more than 3.6 million tons by the year 2015. Pakistan's total installed manufacturing capacity of steel is estimated to be around 4 million tons with capacity utilization averaging around 80%. The following are the major players in the industry:

- Pakistan Steel Mills (the country's only integrated steel plant)
- Steel melters (re-melting imported & locally generated scrap)
- Steel re-rollers (using local manufacturing & imported & ship-demolition rollable materials)
- Ship demolition industry

With an installed capacity of 1.1 million tons, Pakistan steel is the country's only integrated steel plant employing blast furnace and converter technology with total dependence on imported ore and coking coal. Their product mix include continuous cast slabs & billets, rolled billets, hotrolled flat products, thin strip, pig iron and hard coke. In the steel melting sub-sector, there are about 110 units with an installed capacity of 2.0 million tons. Most of these units are run in the informal sector and their product range includes continuous cast billets, thin ingots, and a non-standard product called 'runners'. On the other hand, the installed capacity in the steel re-rolling sub-sector is in the vicinity of 3.2 million tons. Their product mix includes re-bars for the housing & construction sector and a wide range of structural steel sections for industrial and other applications.

Since Pakistan Steel Mills is the sole source of supply for more than 450 medium capacity and small capacity foundries in the country, therefore, it is extremely important to revive PSM. The private sector in the steel industry is mainly clustered in Lahore, Gujranwala and more recently in Peshawar and Noshera. The major impediment to the private sector is the limited availability of power. Steel production's major input is electricity and given the current shortage the industry is extremely handicapped. In the backdrop of the above, Pakistan's policy on steel is to decrease reliance on imports and develop and expand the indigenous steel industry through tripling the capacity of the PSM over the next 5 years to make it economically viable. Incentivize further steel production with a goal of producing 8 million tones of steel indigenously by 2015 by establishing an industrial park.

Fertilizer Industry

Agriculture is one of the major economic sectors of Pakistan contributing around 22% of GDP. Fertilizer industry is one of the key suppliers of raw material to the agriculture sector. Investments in improved fertilizer technology have made a vital contribution to the economy by helping farmers improve crop yield and productivity over the last few years. With population predicted to grow by 19 % by 2025, the country's need for enhanced food production will be critical. Combined with a predicted decrease in arable land up to 25% per capita, the crop yield per acre must rise. The demand supply gap has widened. If further capacity is not added and Pakistan continues to import fertilizer, the burden due to current import subsidy will be immense. Pakistan's fertilizer import - DAP has the highest share in imports as there is only one plant producing DAP in the country.

Keeping in view the demand and to stop ongoing imports of fertilizers in the future, an additional 1,000 - 1,500 tons of urea and 1,000 - 1,500 tons of DAP are needed annually until 2025 to balance the NP ratio. Potassium fertilizer (K) is to be imported because of a lack of any accessible potassium footprint in the country.

V. Regulatory Framework for Investment in Pakistan

Pakistan's investment policy has been formulated to create an investor-friendly environment with a focus on further opening up the economy and marketing the potential for direct foreign investment. Various incentives have been offered to attract foreign investment including full repatriation of capital, capital gains, dividends and profits. Furthermore, according to various economic commentators, Pakistan has the most liberal investment policy regimes and public-private partnership frameworks in the entire South Asian region.

Legal protection to investment

Foreign investment in Pakistan is fully protected by following Acts:

- Foreign Private Investment (Promotion & Protection) Act, 1976.
- Protection of Economic Reforms Act, 1992.

Investment policies

In order to protect and stimulate investment (both local & foreign) in Pakistan, specific investment policies and procedures have been designed for individual sectors. Investment policies specific to the major sectors operating in the country are summarized below whereas policies in general are given in the table at the end of this chapter:

Agriculture

Salient features for Corporate Agriculture Farming (CAF):

- Only such companies (foreign and local) will be entitled to CAF that are incorporated in Pakistan under the Companies Ordinance, 1984.
- State land can be purchased or leased for 50 years through open auction, extendable for another 49 years.
- All banks and financial institutions will earmark separate credit share for CAF.
- Exemption of duty for transfer of land for CAF.
- Dividends from CAF are not subject to tax.
- Raw material for manufacture of agricultural pesticides can be generally imported at zero-percent rate of customs duty.
- Plant & machinery, equipment and vehicles meant for agriculture, harvesting, diary, livestock, poultry, agro-based industries, horticulture and floriculture, etc.under SRO 575(I)/2006 can be imported at zero-percent rate of customs duty.

Construction & Housing

National Housing Policy – 2001

- Housing and construction companies shall be charged via Presumptive Tax Regime which shall not exceed 1% on yearly receipts.
- Stamp duty / registration fee, for the housing mortgage has been rationalized.
- All new construction of houses on plots measuring up to 150 sq. yards and flats having an area of 1,000 sq. feet, have been exempted from all types of taxes for a period of 5 years.
- Banks and DFIs shall extend credit facilities for balancing, modernization and replacement (BMR) of machinery used for housing and construction industry.
- Import of plant and machinery and spares by the housing and construction companies, not manufactured locally, shall be exempted from custom and import duties in excess of 10%.

Textile

Textile Policy 2009-14

- Textiles Investment Support Fund (TISF) will be established under the ambit of the policy.
- Measures proposed for financing from the TISF include:

✓ export refinance available at 5%.

- ✓ long term loans will be converted on the pricing applicable to LTTF scheme, together with a grace period of one year on both existing and converted facilities, without the facility of refinancing.
- ✓ to settle the past claims under R&D scheme of 2007-08, allocation of PKR5.4 billion for the purpose by GoP.
- GoP will contribute part of the investment financing or part of the investment cost through the Technology Up-gradation Fund.
- The policy will focus on certain sub-sector issues from fibre to garments including ginning, spinning, weaving, knitting, processing, fashion designs, handloom and handicrafts, carpets, technical textiles etc.
- The policy offers duty drawbacks of between 1% and 3% for a two-year period for value-added textile exports.
- All textile machinery imports will be zero-rated to encourage new investments.Import duty on raw material, sub components and components used in local manufacturing of textile plants and machinery, has been reduced to zero percent.

Financial Services

- SBP allows complete freedom of investment and repatriation of profits / dividends / disinvestment proceeds to the foreign investors in line with the overall investment policy.
- As per the Foreign Exchange Regulations, any foreign investor can invest in shares / securities listed on Stock Exchanges in Pakistan, and can repatriate profits / dividends or disinvestment proceeds. The investor has to open a Special Convertible Rupee Account with any bank in Pakistan, in order to make such portfolio investments.

IT & Telecom Sector

- Specific licenses are required from respective authorities e.g. in order to start the cellular operation network, a license needs to be obtained from Pakistan Telecommunication Authority.

Energy (Power, Oil & Gas)

- The energy industry is regulated by the Policy for Power Generation Projects 2002, Policy for Development of Renewable Energy for Power Generation 2006 and Petroleum Exploration & Production Policy 2009.
- Customs duty at the rate of 5% applicable on import of plant, machinery & equipment not manufactured locally for power generation projects whilst zero percent customs duty applies on plant, machinery and spares imported by power generation projects under nuclear and renewable energy sources like solar, wind, micro-hydel bio-energy, ocean, waste-to-energy, hydrogen cell etc.
- For power projects above 50MW one-window support to be provided at the federal level. For projects below or up to 50MW support to be provided at the respective provincial level.
- Royalty will be payable at the rate of 12.5% of the value of petroleum at the field gate.

- Local petroleum companies are encouraged to establish joint ventures with foreign concerns.
- Import of equipment related to the petroleum & refining sectors allowed on concessionary rates.
- The lube industry has been deregulated.

Banking

The SBP, the Central Bank of the country was established in 1948. In addition to monitoring the implementation of Banking Companies Ordinance 1962, it specifies regulations relating to the monetary system, credit and banking policy and supervises their implementation.

The main law governing in banking companies in Pakistan is the Banking Companies Ordinance, 1962 that regulates and governs the establishment and running of banking companies in Pakistan, in addition to business of commercial banking.

Some important regulations governing the banking companies in Pakistan

The Banking Companies Ordinance, 1962 and State Bank of Pakistan Act, 1956 specify various regulations, some of which are specified below:

- Capital and reserve requirement
- Cash reserve
- Liquid assets
- Assets outside Pakistan
- Annual accounts and audit
- Remittance of profits
- Number of branches.

Prudential regulations

The SBP has introduced specific Prudential Regulations for Corporate/Commercial Banks, Small and Medium Enterprises Financing, Consumer Financing, Micro Finance Banks/Institutions and Agriculture Financing.

The Prudential Regulations cover four categories viz. Risk Management, Corporate Governance, KYC and Anti Money Laundering, and Operations.

Following are the important conditions prescribed in these prudential regulations for Corporate/Commercial Banks:

- Limit on exposure to a single person
- Limit on exposure against contingent liabilities
- Minimum conditions for taking exposure
- Limit on exposure against unsecured financing facilities
- Linkages between financial indicators of the borrower and total exposure from financial institutions

- Exposure against shares / TFCs and acquisition of shares
- Classification and provisioning for assets
- Payment of dividend
- Margin requirements
- Corporate governance / board of Directors & management
- Credit rating
- Know your customer (KYC)
- Anti-money laundering measures
- Window dressing.

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