

# **SEED WORKING PAPER No. 29**

*Series on Conducive Policy Environment for  
Small Enterprise Employment*

## **Creating a Conducive Policy Environment for Micro, Small and Medium-Sized Enterprises in Pakistan**

by

Small and Medium Enterprise Development Authority of Pakistan  
(SMEDA)

InFocus Programme on Boosting Employment  
through Small Enterprise Development  
Job Creation and Enterprise Department



International Labour Office Geneva

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First published 2002

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ILO  
*Creating a Conducive Policy Environment for Micro, Small and Medium-Sized Enterprises in Pakistan*  
Geneva, International Labour Office, 2002

ISBN 92-2-113351-6

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## Foreword

Policies, institutions and regulations that provide a conducive environment for small enterprises can make a substantial contribution to employment creation. This report is the outcome of a research project undertaken jointly by the International Labour Organization (ILO) and the Small and Medium Enterprise Development Authority of Pakistan (SMEDA), to analyse how the regulatory environment affects the growth of micro, small and medium-sized enterprises (MSMEs) and, in turn, the generation of MSME employment in the economy.

The assessment of the policy environment for small enterprises in Pakistan is based on a careful mapping of existing laws and regulations. Despite reform efforts, small enterprises are still faced with an extremely complex regulatory framework that is difficult to understand and comply with. For example, 136 steps are required for compliance with the Factories Act 1934. Micro enterprises with fewer than 10 workers are exempted from most labour laws. While this exemption decreases the burden of regulatory compliance for micro enterprises, it leaves workers unprotected and can create a growth trap for enterprises whose size places them close to the threshold for compliance.

The ILO's InFocus Programme on Boosting Employment through Small Enterprise Development (IFP/SEED) initiated an international research project on the policy environment for small enterprises and its impact on the volume and quality of employment created by these enterprises. Seven countries participated in this research effort: Chile, Guinea, Pakistan, Peru, South Africa, Tanzania and Viet Nam. This Working Paper is one in a series of country studies and surveys on "Conducive policy environment for small enterprise employment" published by IFP/SEED. The research has been funded through the Dutch Partnership Programme with the ILO, and the ILO and SMEDA would like to thank the Dutch Government for its on-going support for small enterprise development in Pakistan.

The research activities are leading to new policy training materials and policy guidelines. Through action programmes at country and regional levels, SEED works with national stakeholders to assess the policy environment and to strengthen national and local capacities to design, implement and evaluate policy reform. SEED also maintains a database on national policies, laws and regulations pertaining to small enterprise development, which can be consulted on-line on SEED's website (<http://www.ilo.org/seed>).

This report has been written by a team headed by Atif Salim Malik, Manager of the project, and Alia Gogi, Assistant Manager and Survey Coordinator from SMEDA. This report would not have been possible without the contributions of the following persons from SMEDA Policy, Planning and Strategy Department: Asir Manzur (logistic support and guidance); Waseem Beg (exploration of data, analysis and survey coordination); Chaudhry Bilal Sarwar (legal mapping and analysis); Asiha Amjad (mapping and data analysis); Ahwar Dar (support and assistance); and Shehzada Mazhar (legal consultant for regulatory assistance and support). The research was supported and coordinated by IFP/SEED in close cooperation with Gopal Joshi of the South Asia Multidisciplinary Advisory Team (SAAT) in New Delhi and the Country Office in Islamabad. Craig Churchill and Dominique Gross from the ILO Social Finance Programme provided insightful comments on the section dealing with Finance and Credit Policies. Geraldeen Fitzgerald edited the document.

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## List of abbreviations

ADB	Asian Development Bank
CBR	Central Board of Revenue
CE	Census of Establishments
CMI	Census of Manufacturing Industries
EOBI	Employees Old Age Benefit Institution
ESSI	Employees' Social Security Institution
FBS	Federal Bureau of Statistics
GDP	Gross Domestic Product
ISSMI	Integrated Survey of Services and Manufacturing Industries
LFS	Labour Force Survey
MSME	Micro, Small and Medium Enterprise
PKR	Pakistan Rupee
SHMI	Survey of Household and Manufacturing Industries
SMEDA	Small and Medium Enterprise Development Authority
SRO	Statutory Regulatory Order



## Executive summary

In many developing countries, including Pakistan, the issue of SME (small and medium-sized enterprise) development first attracted the attention of academics and policy-makers in the late 1960s. The prevailing concept, based on the “Indian Model”, was to develop small enterprise by the provision of subsidized credits and the establishment of industrial estates and shared facility centres. Apart from some early successes, the results of these government-support programmes in Pakistan were not too encouraging. Inadequate funding, insufficient coordination among development agencies, and the fragmented nature of the programmes were the underlying causes. When foreign support was withdrawn, lack of finance forced these projects to compromise development objectives and concentrate on commercial activities to sustain them.

Recent advances in the field of MSME development highlight the critical importance of an “enabling environment”. Many multilateral agencies sponsoring direct support programmes have shifted part of their resources to finding ways and means of providing a regulatory environment conducive to the sustainable development of the micro and small enterprise sector.

Over the past fifty years, numerous attempts have been made to promote small enterprise development in Pakistan; new governmental departments have been created — the SMEDA being a case in point. However, it is difficult to isolate the small enterprise as a separate entity in policy structures. As yet, no standard definition exists for MSMEs in Pakistan and there is no overall “MSME Policy” arrangement for compliance with the regulatory framework. In the policy areas of finance, business operations and taxation, SME-specific measures are similarly hard to find. Certain provisions (reduced and progressive taxation rates for proprietorships and partnerships, for example) are targeted to MSMEs. But, at the aggregate level, procedures for compliance are heavily biased towards large-scale enterprises operating under well-defined structures in the formal sector.

Unawareness of regulatory requirements at the micro and small enterprise (MSE) level is widespread in Pakistan and access to information is minimal. Bureaucracy, corruption, a lack of transparency, and the payment of extra costs (incurred as “speed money”) add to the burden for micro and small enterprises — already struggling to meet the high fixed costs of compliance with various regulations. The medium-sized firms, familiarized with compliance procedures because of their larger scale of operations, can comfortably meet requirements.

Lack of awareness on the part of micro and small enterprises also results in a low MSE utilization of incentive schemes, such as the “Clean Lending Limits”, a mechanism for issuing small loans without collateral. Unaware of this provision, many micro and small entrepreneurs are unable to access formal credit sources. Special awareness-raising campaigns need to be in place at the national level to promote MSE-specific incentive schemes and initiative packages to nurture their growth.

The unfamiliarity of micro and small enterprises with regulatory procedures tends to encourage the misuse of discretionary powers by government officials, particularly in an environment where opportunities for redress are limited. Freely available information can protect entrepreneurs’ rights and positively affect their business operations.

Effective policy implementation in Pakistan calls for overall improvement in MSME awareness and the access to information on regulatory procedures and requirements. In addition, this report proposes that a standard MSME definition should exist at the national level, to enhance government recognition of the importance of MSMEs in Pakistan and to promote cohesiveness in the implementation — and effectiveness — of policies specifically targeted to the MSME sector.

Because data from secondary sources on the MSME sector proved inadequate or unavailable, various techniques have been used to estimate the total MSME contribution to employment generation and GDP. Primary data sources include a survey of MSMEs, conducted in all four provinces of Pakistan and major MSME clusters. Historically, such empirical studies have concentrated only on the manufacturing sector. This report represents the first time that equal significance has been given to the trade and services sectors in Pakistan.

To collect first-hand information for this analysis, the research methodology included focus-groups to discuss issues that affected men and women entrepreneurs. A women-only focus-group was held in Lahore, in which participants voiced the gender-specific problems of women entrepreneurs.

This report evaluates the main findings from these components in relation to the policy areas of labour, taxation, trade, finance and credit and concludes with an assessment of the impact of the policy framework on employment growth in the MSME sector in Pakistan.

## 1. Introduction

Micro, small and medium-sized enterprises (MSMEs) can play a catalytic role in low-cost employment generation, poverty alleviation, rapid industrialization and economic development. The support systems established by governments are instrumental in nurturing the growth of MSMEs. This report analyses the impact of the regulatory framework on creating a policy environment more conducive to the sustainable development of MSMEs.

In many developing countries, the micro and small enterprise sector has had a past confined by lack of government recognition and few MSME-specific policies. A glance at its history in Pakistan confirms this perspective.

At its independence in 1951, Pakistan had already acquired a small industrial base; the economy relied heavily on the agricultural sector to achieve development objectives. In the first decades after independence, strategic industries were developed in the public sector, with scant attention paid to the development of MSMEs. Various political regimes formulated and implemented strategies for sustainable economic development. Import substitution policies encouraged the capital goods industry. In the early 1970s, a wave of nationalization for the equitable distribution of national wealth discouraged the private sector from investing in industries and other business ventures.

At this juncture, the government realized the importance of small businesses and established provincial small-industry development organizations in the public sector. These organizations followed a direct-support model that involved the provision of support and the establishment of a physical infrastructure. Numerous common facility centres, industrial estates and training institutions were spearheaded by these provincial organizations. Small loan schemes at subsidized interest rates to meet the credit requirements of small-scale industries were also initiated by these institutions. In addition, specialized credit institutions such as the Small Business Finance Corporation (SBFC) were created. These institutions developed and launched specialized products, including Youth Investment Promotion (YIP) and the Self-employment Scheme (SES). To strengthen the entrepreneurial base for women, the First Women's Bank was established in 1989 to provide micro credits.

In the 1980s and 1990s, liberalization policies encouraged the private sector to invest in various sectors of the economy including manufacturing, trade and services. For the MSMEs, it was a period of tremendous growth. In the manufacturing sector, for example, the number of enterprises and the persons employed by micro enterprises increased by almost 60 per cent from 1988 to 1997. Traditionally, however, MSME support has been restricted to subsidized credit programmes and the development of infrastructure. Very little attention was given to evaluating the impact of the regulatory environment on business operations and the dynamics within MSMEs. To fulfil the growth needs of this type of enterprise, it was considered sufficient to provide marketing, technical and financial support. The concept of a conducive environment, based on acknowledging the MSE capacity for non-compliance with regulatory requirements, was not the focus of policy-makers.

To provide support both on a wider scale and at the micro level, the government established the Small and Medium Enterprise Development Authority (SMEDA) in 1998. Its role in policy-making, however, has been limited to policy advice to numerous Government ministries and departments. Through its several business development services, SMEDA has

worked in different SME clusters and collected information on the various regulatory impediments that hinder sustainable growth in the SME sector. The heavy fixed costs of compliance with tax, labour, trade and financial regulations induce SMEs to operate informally, given their limited financial resources and their unawareness of (or lack of access to) regulatory requirements.

The scarcity of literature on the behaviour of micro, small and medium-sized firms with regard to the regulatory framework spurred SMEDA's collaboration with the International Labour Organization on the project "Creating a Policy Environment Conducive to Employment Growth within Micro, Small and Medium Enterprises".

### ***Objectives***

Project objectives are set out below:

To increase understanding of how the national policy, legal and regulatory environment affect the generation and quality of employment in micro, small and medium enterprises;

To ascertain the existing range of information (at both national and international levels) on employment within MSMEs, particularly job quality, gender and age;

To identify future research priorities in this field; and to disseminate the findings of this research that will evoke practical responses to promoting new and better jobs in the micro and small enterprise (MSE) sector.

### ***Methodology***

Research was structured so that information on MSMEs from reliable secondary and primary sources has been compiled, analysed and synthesized. Primary data collection consisted of a survey of 333 MSMEs to analyse their behaviour in complying with the complex regulatory framework, including tax, labour and financial regulations. The survey was conducted in all four provinces and major MSME clusters. The main findings of this survey can be found in Gallup/BRB Pakistan (forthcoming). It should be noted that empirical studies of this nature in Pakistan are usually confined to the manufacturing sector. For the first time, this report gives equal weight to the trade and services sectors, which have a large MSME presence. Six focus-group discussions were also conducted in MSME clusters including Sialkot, Gujranwala, Karachi, Peshawar, and Quetta. To voice the gender-specific issues faced by women entrepreneurs, a women-only focus-group discussing these problems was conducted in Lahore.

Secondary research for this report was not confined to a review of the available literature on the MSME sector. More than 100 laws and regulations were mapped to evaluate their effect on business operations, employment creation and the decision-making process in the MSME sector of Pakistan. The analysis of regulations was also conducted to determine the necessary steps and the costs involved in compliance — a useful exercise to ascertain the extent of the discretionary powers laid down in numerous laws.

Government departments in all policy areas (taxation, labour, finance, trade and business operations) were contacted to obtain inputs on implementation of regulations. This phase played a vital role in drawing inferences, while maintaining a balance between entrepreneurs' perception of regulations and the actual issues involved in their

implementation. Initial findings were presented in policy focus-groups, with key government institutions represented. These focus-groups helped to fine-tune the observations, results and recommendations contained in this report.

### ***Defining MSMEs***

As in a number of developing countries, there is no standard definition of micro, small and medium-sized enterprises (MSMEs) in Pakistan. For this analysis, MSMEs are defined as follows:

The term “micro and small enterprises” refers to non-agricultural enterprises. Micro enterprises have 1 to 9 workers; small enterprises 10 to 49 workers. Self-employed workers are thus considered as a micro enterprise.

For the purposes of the SMEDA/Gallup MSE Survey (2001) self-employed have been excluded. Small enterprises are defined as having between 10 and 35 workers (not 49) (see Part 3). Note that this difference does not affect the findings of the present report and has allowed Gallup to collect data on medium-sized firms (coverage was from 36 to a maximum of 49 workers).

Finally, as part of this research, SMEDA has proposed a new definition of the MSME at a national level also — by using *either* the number of employees *or* the asset size of enterprises — which is still not recognized in the regulatory framework.

Part 2 of this report now looks at the present socio-economic situation in Pakistan, reviewing its economic growth over the past 50 years. Budgetary strategies and policy formulation practices are described, to provide a background to the current planning climate and the problems and opportunities that arise in the formulation of economic policy on MSME development.

## 2. Macroeconomic overview and policy formulation

### 2.1 A brief survey of economic development in Pakistan

The economy of Pakistan has undergone a thorough restructuring process, as Table 2.1 shows, comparing the socio-economic situation at independence in 1951 and at the end of the twentieth century. For a chronology of the key events affecting economic performance in Pakistan between 1963 and 1998, see Annex 1.

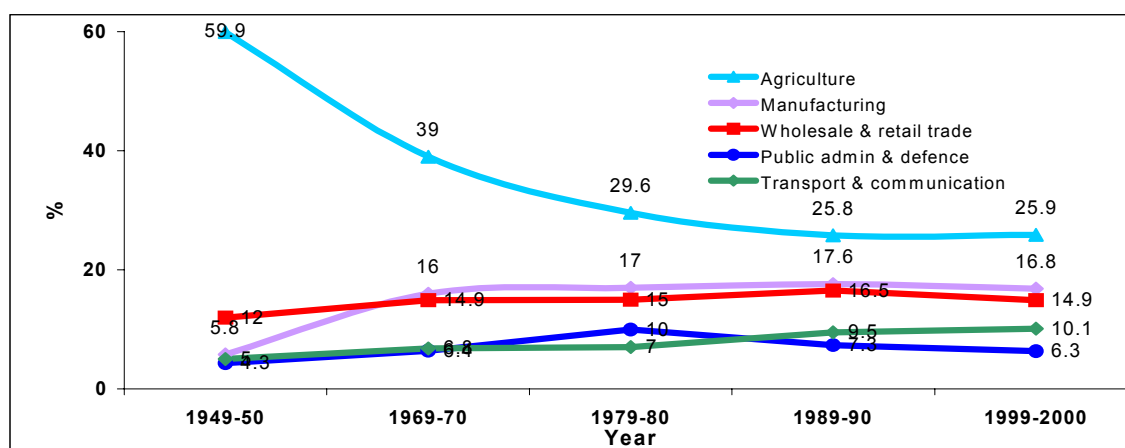
**Table 2.1: Pakistan: Basic indicators, 1947-2000**

	1951	2000
Population (millions)	33.78	137.5
Urban (%)	17.8	35.9 (1998)
<b>Contribution to GDP by sector (%)</b>	<b>1949/50</b>	<b>1999/2000</b>
Agriculture	53.2	25.9
Industry	7.8	24.7
Services and Trade	39	49.4
<b>Labour force by sector (%)</b>	<b>1950/51</b>	<b>1997/98</b>
Agriculture	65.3	47.3
Industry	9.5	17.1
Services and Trade	25.2	35.6
<b>PPP real GDP per capita (US\$)</b>	<b>820 (1960)</b>	<b>2,160 (1993)</b>
<b>Composition of exports (%)</b>	<b>1951/52</b>	<b>1995/96</b>
1- Primary commodities	99.2	16
2- Semi-manufactures		22
3- Manufactures		63
	<b>1951</b>	<b>1998</b>
Literacy (%)	15	44
Female literacy (%)	12	29
Life expectancy (years)	43 (1960)	62
Infant mortality rate (per 1,000 live births)	137 (1960)	91

Sources: Zaidi (2000), World Bank (2000b), Asian Development Bank (2001) and Federal Bureau of Statistics: Labour Force Survey 1997/98.

The composition of GDP from 1951-2000 clearly indicates a shift from agriculture to other sectors including manufacturing, trade and services. The government also planned for rapid industrialization, in order to keep pace with the growth rates of the labour force. Figure 2.1 gives the sectoral shares in GDP over the past 50 years.

**Figure 2.1: Sectoral shares in GDP (percentage)**



Source: FBS, *Fifty Years of Pakistan Statistics I: 1947-1997*, and Asian Development Bank (2001).

The 1950s was a decade of virtual stagnation. The 1960s saw a successful strategy to raise investment by enhancing domestic savings and foreign aid and accelerating the pace of industrialization. Economic growth was at the rate of 6.8 per cent a year. The manufacturing sector had the fastest growth, at 9.9 per cent, a figure as yet unmatched by any other decade, as Table 2.2 shows. However, the focus on large-scale development projects failed to benefit the smaller enterprises and the lower-income groups of the population.

**Table 2.2: Growth rates in Pakistan (average annual growth, percentage)**

	1960-1969	1970-79	1980-89	1988-1997
GDP	6.7	4.8	6.4	4.7
Manufacturing	9.9	5.5	8.2	4.9
Commodity-producing	6.8	3.8	6.4	4.6
Services	6.7	6.2	6.6	4.7

Source: Government of Pakistan, *Pakistan Economic Survey, 1996-97*.

In the 1970s, some landmark policy measures were adopted, including the nationalization of all major industries and the financial sector, the historic devaluation of the Pakistan rupee, and the development of industries under high tariff protection and the provision of export subsidy. Another significant development was the formulation and implementation of labour reforms, leading to the creation of many small and medium-sized industries. The rationalization of cost structures changed the focus of the industry from vertical integration to specialization. During this period, economic growth was at the rate of 4.3 per cent per year.

The 1980s saw trade liberalization, the opening of a foreign exchange and payments regime and the harnessing of the private sector to become the engine of economic growth. In this decade, trade and industrial policy shifted in emphasis: from inward-looking import substitution to outward-looking export promotion. Fixed investment declined but the GDP growth rate showed an upward trend. All sectors except services and construction showed improved growth performance. The overall GDP grew at an annual rate of 6.6 per cent and large-scale manufacturing at 16.6 per cent a year.

**Economists generally view this period as holding the key to the current problems and opportunities for development. Four factors are particularly relevant in this context.**

First, the economic growth in the 1980s coincided with a number of external shocks to Pakistan's economy. The migration of Pakistani workers to neighbouring oil-rich countries, begun in the mid-1970s, escalated in this decade. Workers' remittances became the largest single source of foreign exchange earnings; in 1982-83 they peaked at over one-tenth of GDP. In addition, the Afghan war resulted in the decision of the military regime to play a frontline role; considerable financial flows from abroad followed in the form of economic and military aid.

Second, Pakistan's economy in the 1980s was inconsistently managed. Although the military government introduced tight fiscal and monetary policies at the outset, this regime was abandoned within 3 years. Since the late 1980s, the economy has been under the guardianship of international lending agencies, as a consequence of heavy borrowing in the early 1980s. Both the International Monetary Fund and the World Bank recommended liberalization, stabilization and structural adjustment programmes to curb fiscal deficit. Their prerequisite requirement was reducing the deficit to 4 per cent of GDP. The largest cuts in public expenditure have been in the development area, falling from 9.3 per cent of GDP in 1981 to approximately 3.5 per cent in 1996/97.

Third, the low-income groups were the main beneficiaries of the public-sector development programmes. Inflation and tax increases have most affected this segment. Both salaried and low-income groups have been unable to negotiate wage increases. Repeated price rises for electricity, gas and fuel have had a deteriorating effect on the purchasing power of the poor. In a further attempt to reduce fiscal deficit, the government imposed more indirect taxes, thus adding to the burden on this group.

Finally, the policy of privatization, begun in the mid-1980s, was accelerated in 1991 by the Privatization Commission. Besides privatizing various nationalized institutions, the government also opened some sectors to private-sector investment. The liberalization of the financial sector resulted in the growth of commercial banks and leasing companies. Competition stepped up in the financial sector, struggling to discover niche markets that would lead to a broader credit base. This markedly assisted capital accumulation in small and medium-sized industries.

## **2.2 Economic policy-making**

### **2.2.1 Development planning**

Development planning in Pakistan spans the short, medium and long term (15-20 years). An important perspective for overall macro-level policy-making is medium-term planning, commonly referred to as the Five-Year Plans. Eight such plans have been implemented to date; their purpose is to review past performance in different sectors of the economy and to target future priorities. They serve as a 'road map' to facilitate government decision-making and allocation of funds. Since they are based on set economic objectives, these five-year plans are not only relevant to large-scale businesses. For example, SME development was given priority in the Sixth Five-Year Plan (1983-88), which listed measures such as facilitation of small investors by providing infrastructure and developing linkages between large- and small-scale manufacturing to promote sub-contracting.

The Eighth Five-Year Plan (1993-98) went one step further by including a separate chapter on SME development. Policy announced in this plan included:



Improving productivity and enhancing quality and standards through training in vocational and technical skills, modernization and technological upgrading.

The establishment of common facility and service centres for the provision of necessary equipment, raw materials, and technical services; providing information regarding input and output markets, credit etc.; preferably in close proximity to, or among, the cluster of small and micro enterprises through an autonomous and decentralized agency/private sector actor.

Provision of infrastructure and transport facilities for setting up small-scale industries in non-industry/lagging areas to remove regional imbalances.

This was a positive step by the government in acknowledging the importance of SMEs for economic development. But there were two weaknesses. Although policy was directed at SME development, there was no standard definition of the SME. This is still the case in Pakistan (see also Section 3.1). A second weakness was that SMEs were considered as operating only in the manufacturing sector.

Short-term planning is the perspective of the Annual Development Plans, prepared and announced annually by the Ministry of Finance. In order to ensure harmony in the policy framework, they take into account the sectoral preferences and allocations set down in the five-year plans. This policy-making machinery operates among all four provinces in Pakistan. At provincial level, individual annual development plans are conceived using the input obtained from various provincial ministries. With the exception of matters dealt with exclusively by the Federal Government (defence, foreign affairs, trade and commerce, internal affairs), each province has its own ministries.

### **2.2.2 *The annual budget***

Before the beginning of each fiscal year (1 July to 30 June) the Federal Government announces the annual budget and its decisions on various budgetary issues including tax rates for income, sales and excise levies and revisions to the tariff structure through customs duties. Although the government announces other measures that provide relief to lower income groups and micro enterprises, none are specific for the SME sector. In sum, despite SME development planning efforts, the lack of government recognition and the absence of a standard definition continue to create impediments for SMEs.

### **2.2.3 *Formulating policy: Functions of federal and provincial governments***

The Federation of Pakistan is governed by the 1973 Constitution of Pakistan, which defines all functions both of federal and provincial governments. Federal functions comprise both a regulatory and service nature, as Table 2.3 shows. Service functions include defence, external affairs, currency, stock exchanges, national highways and strategic roads, railways and utilities, which are exclusively federal responsibilities. A concurrent legislative list of functions may be performed both at a federal or provincial level; all other functions specified in the Constitution are the responsibility of provincial governments.

Although provincial governments can formulate and implement policies in some policy areas, centralization prevails. Labour policy, for example, is formulated by the federal government, with the provinces empowered to make rules in the light of guiding principles

provided by federal government. Taxation policy is also formulated at the federal level, with all major taxes levied and collected by the Central Board of Revenue (CBR).

**Table 2.3: Legislative responsibility: Federal, provincial and local levels**

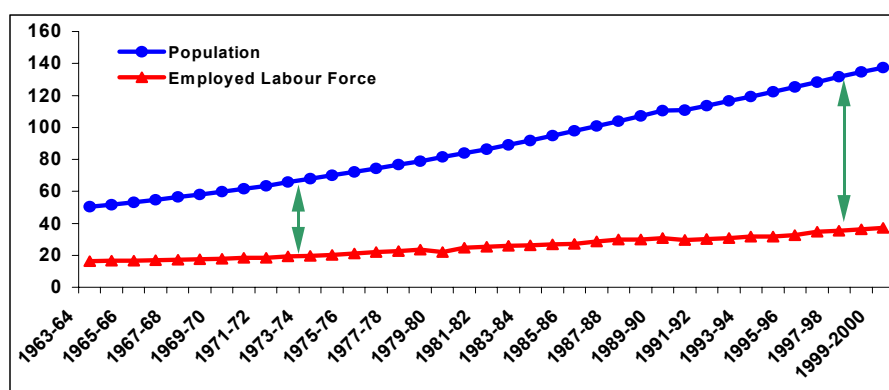
Legislative responsibility	Services	Actual allocations of functions
Federal Government	Defence External affairs & foreign aid Post, telegraph, telephone, radio & TV Currency and foreign exchange Nuclear energy Parts & aerodromes Shipping, air service, railways, and national highways Stock exchanges Geographical and meteorological surveys Censuses Mineral oil and natural gas Industries	Federal Government
Federal/Provincial Governments	Population planning Electricity (except KESC) Curriculum development, syllabus planning & centres of excellence Tourism	Federal/Provincial Governments
	Social welfare and employment exchanges Vocational/technical training Historical sites and monuments	
Provincial Governments	Law & order, justice Highways and urban transport Agriculture extension and distribution of inputs Irrigation and land reclamation Secondary and higher education	Provincial Governments
Local Governments	Curative health Land development Primary education	Provincial/Local Governments
	Preventive health Farm-to-market roads Water supply, drainage & sewerage	
	Link roads Intra-urban roads Street lighting Solid waste management Fire fighting Parks, playgrounds	

Source: "Structure of governments in Pakistan", *News of Friday, Karachi*, 25 August 1996.

### 2.3 Labour market profile

Over the past 50 years, mainly because of the high population growth rate, the gap is widening between the employed labour force and the overall population, as Figure 2.2 shows. The unemployment rate has doubled in the past decade and is currently around 6 per cent. In absolute terms, the estimated size of the employed labour force is approximately 38 million, which is almost 28 per cent of the total population. While women account for 48 per cent of the total population, they form only 14 per cent of total employment.

**Figure 2.2: Widening gap of population and employed labour force (million)**



Source: FBS, *Fifty Years of Pakistan Statistics I: 1947-1997* and Asian Development Bank (2001).

The crude labour force participation rate for women is as low as 9.4 per cent; for men, it is 48 per cent. Almost 70 per cent of total employment is in rural areas; with a notable over-representation of female employment: 84 per cent of total female employment is in rural areas, compared with 68 per cent of male employment. This is attributable to the male ‘breadwinner’ model in prevailing socio-cultural norms; women participating in economic activities such as farming usually offer their services as unpaid family helpers.

### 2.3.1 The formal and informal sectors

Table 2.4 provides a picture of the composition of sectoral employment. A total of 19 million workers (almost 53 per cent of the labour force) are employed in non-agricultural activities in the manufacturing, services, trade, mining and construction sectors. Within the non-agricultural sector, the informal sector provides employment to almost 68 per cent of the labour force. The majority of micro and household enterprises are in the informal sector.<sup>1</sup> Women (similarly to the overall labour force composition) constitute only 8 per cent of the total labour force in the informal sector. The segment of employers represents 1 per cent, self-employed 28 per cent, and employees 30 per cent. Unpaid family helpers comprise 8 per cent of informal sector workers. For a detailed discussion of MSME activity in both the formal and informal sectors, see Part 3.

**Table 2.4: Composition of employment, 1997/98 (million)**

	Both Sexes	Male	Female
Agricultural Sector	17.0	13.5	3.5
Non-Agricultural Sector, of which:	18.9	17.4	1.5
Formal	6.1	5.6	0.5
Informal	12.8	11.9	1.0
Total	35.9	30.9	5.0

Source: FBS, *Labour Force Survey, 1997/98*.

Part 3 analyses the existing secondary data sources in an attempt to quantify the economic significance of MSMEs by economic sector, their contribution to employment and GDP, as well as employment quality in MSMEs.

<sup>1</sup> Enterprises (or self-entrepreneurs) with less than 10 workers are not legally required to register with any government department or agency.

### 3. Economic significance of MSMEs in Pakistan

#### 3.1 Defining MSMEs

As noted in the Introduction, Pakistan has no standard definition of the MSME. Various government departments and public-sector agencies have created their own definitions, based mainly on financing needs. Other critical parameters (investment, technology, human resource development — and the regulatory framework) are generally not included, as Table 3.1 shows. The SMEDA has proposed defining these enterprises in terms of *either* their assets *or* their number of employees, so that development programmes could be initiated with more focus.

*Table 3.1: Current definitions of the MSMEs, Pakistan, 2001*

Institution	Micro	Small	Medium
State Bank of Pakistan	N/A	Capital assets up to PKR 20 million (excl. land & building) Revised in 1992	N/A
Federal Bureau of Statistics	N/A	Less than 10 employees	N/A
Small Business Finance Corporation	N/A	Productive assets up to PKR 20 million	Prod. assets of PKR 20-100 million- Revised in 2001
Punjab Small Industries Corporation	N/A	Fixed investment up to PKR 20 million (excl. land & building)	N/A
Small & Medium Enterprise Development Authority	Less than 10 employees, or prod. assets up to PKR 2 million	10-35 employees, or prod. assets from PKR 2–20 million	36-99 employees, or prod. assets from PKR 20–40 million

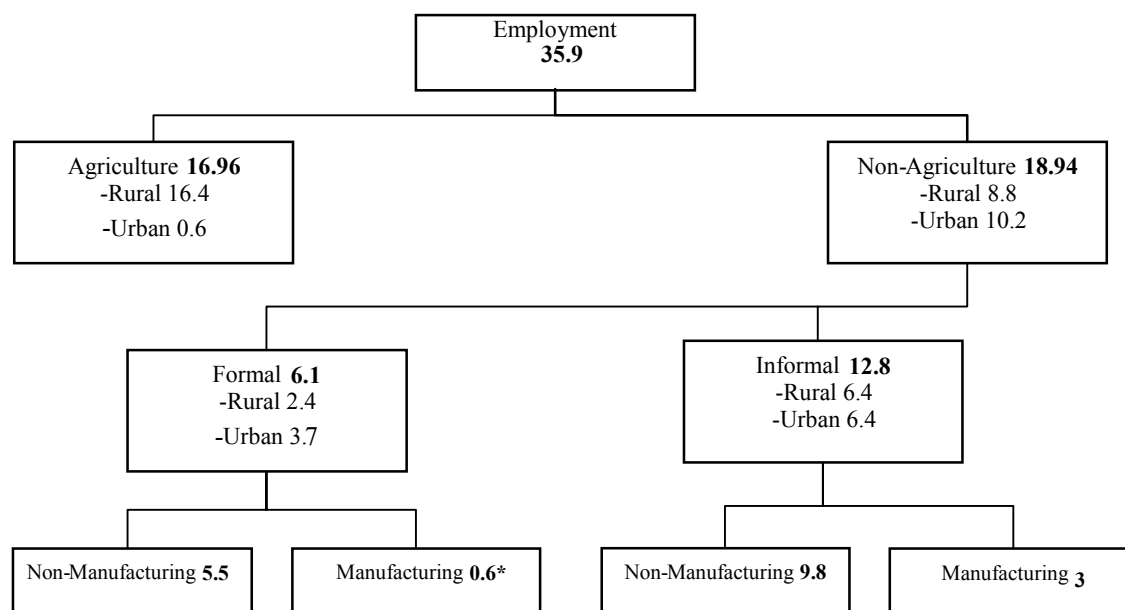
*Note: PKR 60.18 = US\$1.*

*Source: SMEDA.*

#### 3.2 Employment statistics according to various sources

It should be stressed at the outset that wide discrepancies exist between various data sources on total labour force estimates for Pakistan. Figure 3.1 maps the sectoral distribution of employment according to the 1997-98 Labour Force Survey (LFS) data, with the total employed labour force estimated at 35.9 million.

**Figure 3.1: Employment distribution in Pakistan, 1997-98 (millions)**



\* CMI 1995-96.

Source: Labour Force Survey, 1997-98.

The share of the non-agricultural sector is 53 per cent. Further disaggregation of data is done on the basis of formal and informal sector. ‘Informal’ is here defined as comprising those establishments that are not registered with any government department or agency. All establishments of less than 10 workers fall under this definition given that they are not required to register under labour law. Almost 68 per cent of non-agricultural employment is estimated to be in the informal sector — indicating that the majority of establishments in the non-agricultural sector are micro enterprises.

According to the Census of Manufacturing Industries 1995-96,<sup>2</sup> total employment in the formal manufacturing sector is 0.6 million (or 10 per cent of the total formal non-agricultural sector employment) The remaining employment in the formal non-agricultural sector is absorbed by the trade and services sectors, as estimated by the LFS data, 1997-98.

Employment in the informal manufacturing sector may be estimated at 3 million persons,<sup>3</sup> with a share of 23 per cent of the total employment in the informal non-agricultural sector. Thus, 77 per cent of non-agricultural informal employment is being generated by micro enterprises in the services and trade sectors.

<sup>2</sup> The CMI is a census of all manufacturing sector establishments that are registered under the Factories Act 1934. The data might be underestimated, as not all the registered establishments report their data in the census whereas they might as well be in operation at the time of the census. Data from the latest CMI are for 1995-96 while data from the LFS survey are for 1997-98. However, as there was hardly any growth in the registered manufacturing employment between 1990-91 and 1995-96, it can be safely assumed that the growth between 1995-96 and 1997-98 would be minimal and no extrapolation between these two years is necessary.

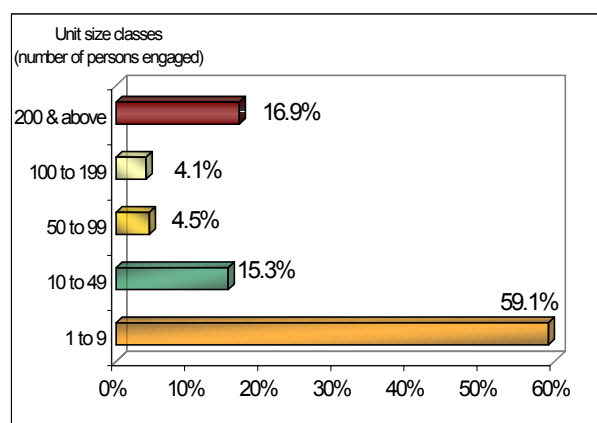
<sup>3</sup> Obtained by deducting employment in the formal manufacturing enterprises (CMI data for 1995-96) from that of total employment in manufacturing according to LFS data.

An example of the differences in various data sources on total labour force is the above-mentioned estimate of 3 million for total informal manufacturing sector (micro enterprises) employment, using LFS and CMI data. According to the Survey of Household and Manufacturing Industries, 1995-96 (SHMI), which covers informal sector enterprises, the total employment is around 1.26 million — a discrepancy of 1.74 million, owing to varying methodologies, coverage and scopes in these surveys.<sup>4</sup> Nevertheless, it is important to attempt an estimate of the share of MSMEs in total employment activity.

The LFS data do not provide a breakdown according to enterprise size. The Integrated Survey of Services and Manufacturing Industries (ISSMI 1991-92) data only cover small enterprises and do not permit to estimate the employment share of medium-sized enterprises.

Data from the Census of Establishments (CE 1988) which cover all non-agricultural establishments,<sup>5</sup> provide a reasonable basis to estimate the employment shares based on enterprise size, although the date is not current. The Census estimated the number of establishments at slightly above 2 million, providing employment to 5.66 million workers. It furnishes significant information on the role of micro enterprises and their employment-generating capability. As shown in Figures 3.2 and 3.3, 97 per cent of the establishments surveyed were micro enterprises (less than 10 workers) and provided employment to almost 60 per cent of the population.

**Figure 3.2: Distribution of employment by unit (establishment) size classes, 1988**

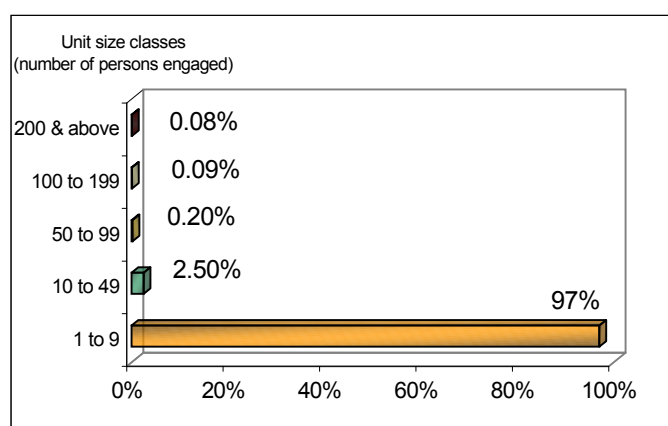


Source: Census of Establishments, 1988.

<sup>4</sup> The Labour Force Survey is a household survey and includes individuals over the age of 10 who have worked for even one hour during the survey reference week. In principle, data are collected on employment in all types of establishments, irrespective of size, location, type of activity, etc. The SHMI is an establishment survey covering all un-registered household units and small manufacturing establishments irrespective of their employment size which are engaged in manufacturing activities, excluding Federally Administered Tribal Area (FATA) and Military restricted areas. The repair and servicing of consumer goods such as shoes, bicycle, watches, radio, TV, motorcars, electrical appliances and domestic appliances are not treated as industrial activities and therefore are not covered in the survey. Data in the SHMI might be prone to underestimation, owing to the mobile nature of informal sector enterprises.

<sup>5</sup> It is important to note, however, that the CE 1988 includes all non-agricultural establishments with a permanent and identifiable location, including those that are government-owned. Pavement vendors, street traders, etc. who do not have a permanent place of business are therefore excluded from the scope of the CE. Similarly, unpaid family helpers are included only if they have been engaged at least one-third of regular working time during the reference period. There might also be a certain degree of under-reporting in the rural areas.

**Figure 3.3: Distribution of units according to size classes**



For the purposes of this analysis, data on employment have been extrapolated at a 3 per cent average labour force growth rate from 1988 to 1997-98, so that a comparable range of statistics can be established with the labour force survey. Results are presented in Table 3.2.

**Table 3.2: Estimated employment in the MSME sector, 1997-98**

<b>Manufacturing Sector</b>		
Micro	<b>875,449</b>	11.8%
Small	439,044	5.9%
Medium	112,217	1.5%
<b>Total</b>	<b>1,426,710</b>	<b>19.2%</b>
<b>Trade</b>		
Micro	2,014,489	27.2%
Small	45,664	0.6%
Medium	5,056	0.1%
<b>Total</b>	<b>2,065,208</b>	<b>27.8%</b>
<b>Services</b>		
Micro	1,508,796	20.3%
Small	584,124	7.9%
Medium	205,383	2.8%
<b>Total</b>	<b>2,298,303</b>	<b>31.0%</b>
<b>Overall employment MSMEs</b>	<b>5,790,221</b>	<b>78.1%</b>
<b>Large-scale employment</b>	<b>1,624,662</b>	<b>21.9%</b>
<b>Total estimated employment</b>	<b>7,414,883</b>	

*Note: Micro enterprises are defined here as less than 10 persons engaged; small units as 10 to 49 persons engaged, and medium units as 50 to 99 persons engaged.  
Source: SMEDA based on the Census of Establishments 1988.*

An interesting feature of these estimates is that the figures for the manufacturing sector<sup>6</sup> are close to those estimated by both the SHMI 1996-97 and CMI 1995-96 data. Overall employment in micro manufacturing enterprises is around 1 million according to SHMI data, a figure comparable with that of the .875 million estimated for micro enterprises in Table 3.2. Similarly, estimated employment of around 0.45 million for small enterprises in

<sup>6</sup> Due to a lack of comparable data in other sectors, most estimates are based on the manufacturing sector.

the manufacturing sector compares with that of the 0.35 million given in the CMI and SHMI data.

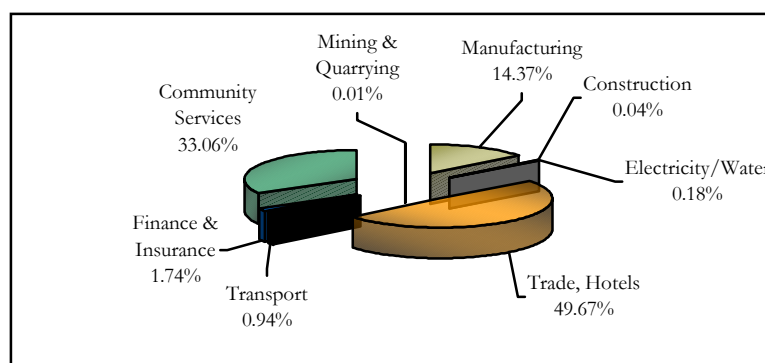
### 3.3 Employment analysis by sector

To develop a profile of the MSMEs in Pakistan and their employment contribution by economic sector, existing secondary data sources were analysed. They provided fragmented and inconsistent information. Most available data deal only with the manufacturing sector. The trade and services sectors are surveyed in the Census of Establishments, which has been conducted only once, in 1988.

#### 3.3.1 Overview

As Figure 3.4 shows, the highest concentration of units (49.67 per cent) is in the trade/hotel sector, which includes enterprises in retail or wholesale trade, restaurants and hotels.<sup>7</sup> The community services sector represents a share of 33 per cent of the total number of units. Interestingly, the number of manufacturing sector firms is similar to that given by the Survey of Small and Household Manufacturing Industries (SHMI) data for 1987-88.<sup>8</sup>

**Figure 3.4: Sectoral distribution of units, 1988**



Source: Census of Establishments, 1988.

The community services sector contributes almost 39 per cent of the employment total; the manufacturing sector almost 28 per cent, according to the 1988 Census of Establishment data presented in Table 3.3. The trade/hotel sector dominates the overall number of units and provides employment to 27 per cent of the total employed, by reason of its high concentration of micro-sized units. The employment contribution of the other sectors is relatively negligible.

**Table 3.3: Sectoral distribution of employment, 1988**

Employment	Mining & Quarrying	Manufacturing	Electricity/ Water	Construction	Trade, Hotels	Transport	Finance & Insurance	Community Services
Total	16,432	1,622,663	19,300	4,671	1,548,134	74,151	199,602	2,237,234
Share in employment (%)	0.3	28.4	0.3	0.1	27.1	1.3	3.5	39.1

Source: Census of Establishments, 1988.

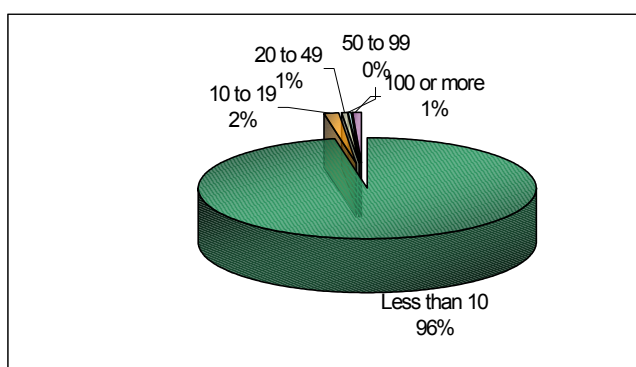
<sup>7</sup> For ease of reference, as there is a very fine line classifying hotels as either in the trade or services sectors and, as these units are dominated by small-scale road-side restaurants, the present authors have included them with trading enterprises.

<sup>8</sup> The SHMI data estimate the number of micro enterprises at 257,000, which approaches that of the 1988 Census of Establishments data (287,000). The number of formal manufacturing firms is very small.



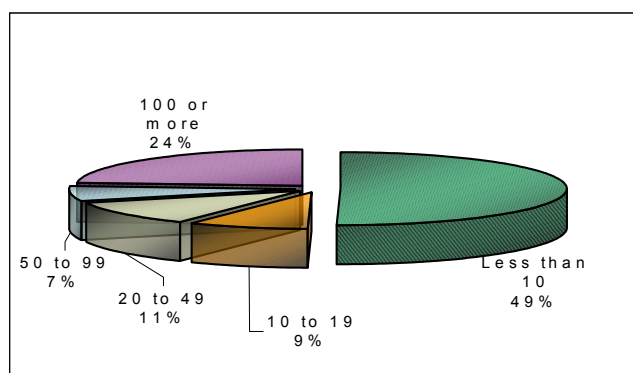
Figures 3.5 and 3.6 show the distribution of employment by unit sizes and the significance of micro enterprises in the two largest trade and services sectors. In the trade/hotel sector, almost 96 per cent of employment is generated by enterprises with less than 10 persons engaged (Figure 3.5). Average employment per unit is only 1.5, reflecting a high presence of self-employed workers who operate a retail stall or food outlet, often in the local markets. In the community services sector, the highest contribution to employment is from units with less than ten workers — a share of almost 50 per cent of the employment total. A 24 per cent employment share is generated by enterprises with more than 100 workers in large-scale public and private sector establishments (Figure 3.6). The average employment per unit in the community services sector is 3.4, considerably higher than the trade/hotel sector average of 1.5.

**Figure 3.5: Distribution of employment by unit size classes in the trade/hotel sector, 1988**



Source: Census of Establishments, 1988.

**Figure 3.6: Distribution of employment by unit size classes in the community services sector, 1988**



Source: Census of Establishments, 1988.

Another source of information covering services and manufacturing is the Integrated Survey of Services and Manufacturing Industries (ISSMI 1991-92).<sup>9</sup> This survey was never published, due to certain gaps. At an aggregate level, results are consistent with that of the Census of Establishments 1988, but at the sectoral level slight discrepancies occur between the two sources. For example, according to the ISSMI 1991-92 data, 2.3 million establishments provide employment to over 5 million workers. The share of the

<sup>9</sup> This information was obtained from *Small Scale Sector in Pakistan* by Dr. Younus Jafri (Federal Bureau of Statistics).

manufacturing units is 16 per cent; for the community services sector units 29 per cent and for the trade/hotels sector it is 55 per cent.

The ISSMI covers only small-sized firms, and almost 98 per cent of all enterprises in the ISSMI sample are micro enterprises (with a share of 88 to 91 per cent — depending on sectors — of the total employment in surveyed enterprises). According to the ISSMI data, the trade/hotel sector has the largest share (50 per cent) of employment in the sample, which is higher than estimated by the Census of Establishments, 1988. The community services sector contributes another 26 per cent to total employment; the manufacturing sector a share of 23 per cent.

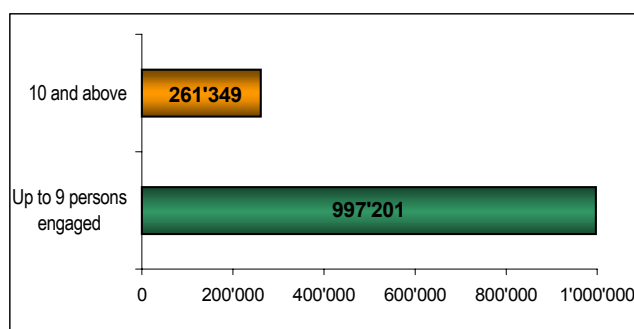
### 3.3.2 Formal and informal MSME employment in the manufacturing sector

A considerable amount of information is available on the manufacturing sector. The Survey of Small and Household Manufacturing Industries (SHMI) provides useful insights into informal sector employment. Data on the manufacturing industries operating in the formal sector are available from the Census of Manufacturing Industries (CMI), 1995-96.

#### 3.3.2.1 Informal (unregistered) MSMEs in the manufacturing sector

Prior to 1996-97, the coverage of the SHMI was limited to those enterprises unregistered with any government agency and employing less than ten workers.<sup>10</sup> To enhance its coverage and to determine the extent of informal-sector activity in the manufacturing industries, the SHMI 1996-97 survey included firms, regardless of their size, that were *not* registered with any government department. According to the SHMI 1996-97 data, total employment in informal-sector manufacturing enterprises is around 1.26 million, as shown in Figure 3.7. Approximately 428,000 household<sup>11</sup> and small manufacturing units are operating in the informal manufacturing sector.

**Figure 3.7: Number of workers in informal manufacturing units, 1996-97**



Source: Survey of Small and Household Manufacturing Industries, 1996-97.

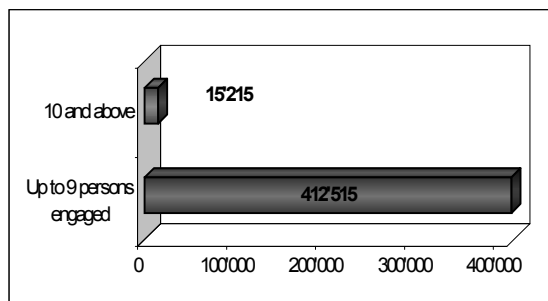
Almost 60 per cent of these units are located in rural areas: this high concentration is consistent with the population pattern of Pakistan. An interesting feature of the SHMI data in Figure 3.8 is its estimate of 15,215 units, employing ten or more individuals in the informal sector. With average employment per unit estimated at 17.4, this implies that a high proportion of employment is generated by small enterprises that are *not* registered, despite

<sup>10</sup> Enterprises employing less than 10 workers are not legally required to register with government departments such as the Department of Labour.

<sup>11</sup> Household units are defined as those in which the manufacturing activity and the residence of the entrepreneur share the same premises.

employing ten or more workers. The value-added contribution of informal sector firms is 7.8 per cent of the total manufacturing value-added of Pakistan.

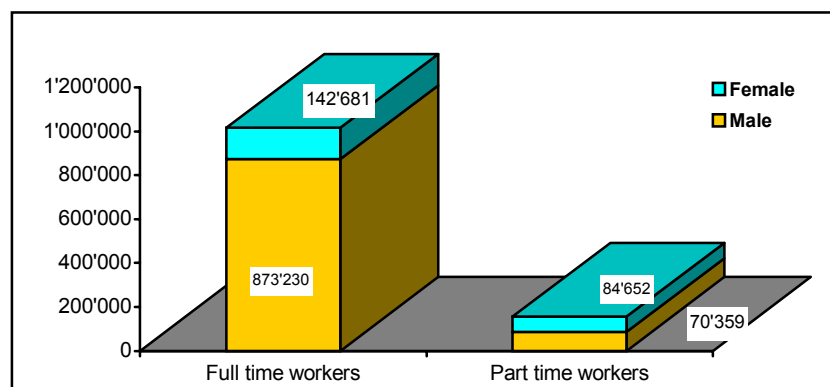
**Figure 3.8: Number of units in the informal manufacturing sector, 1996-97**



Source: Survey of Small and Household Manufacturing Industries, 1996-97.

Men workers (83 per cent of total employment) and full-timers (81 per cent of total employment) dominate the informal manufacturing sector. The share of women workers in the informal sector is very small. As shown in Figure 3.9, almost 37 per cent of women workers are employed part-time compared with only 8 per cent of men workers.

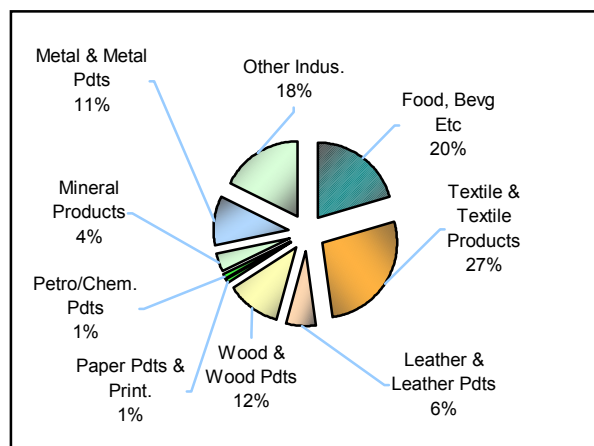
**Figure 3.9: Distribution of full-time and part-time workers in the informal manufacturing sector, according to sex, Pakistan, 1996-97**



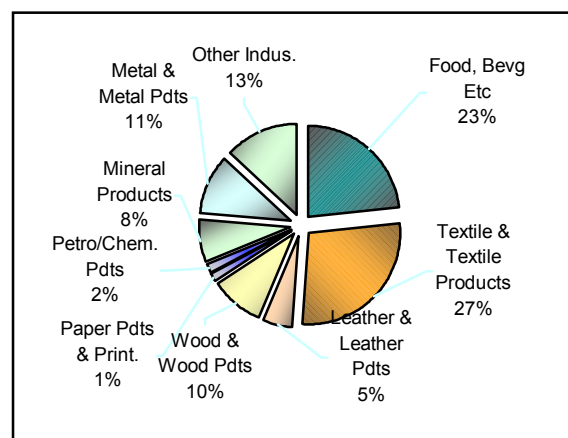
Source: Survey of Household and Manufacturing Industries, 1996-97.

The textile sector is the most important economic activity in the informal manufacturing sector, both in terms of number of units (almost 27 per cent of the total units) as shown in Figure 3.10, and of its employment contribution (27 per cent of the total employed in the informal manufacturing sector), as Figure 3.11 shows. This includes activities such as small-scale spinning of cotton yarn, dyeing and weaving of fabric and apparel stitching. Other significant sectors include metal products manufacturing, food and beverage products, mineral products and wooden products.

**Figure 3.10: Informal manufacturing units by sector, 1996-97**



**Figure 3.11: Informal manufacturing employment by sector, 1996-97**



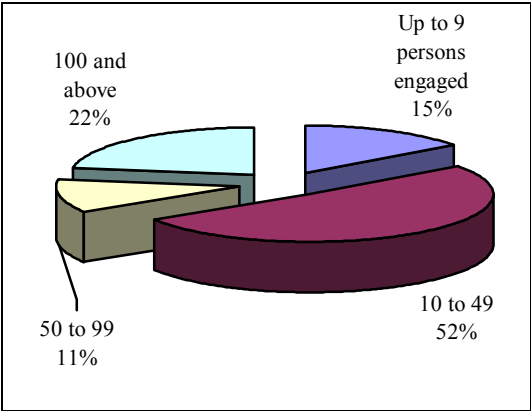
Source: Survey of Household and Manufacturing Industries, 1996-97.

### 3.3.2.2 Formal (registered) MSMEs in the manufacturing sector

The Census of Manufacturing Industries conducted in 1995-96 provides information on the manufacturing concerns operating in the formal sector.<sup>12</sup> This survey reported the total number of manufacturing concerns is only 4,474. As Figure 3.12 shows, most units are concentrated in the segment employing 10 to 49 persons. Almost 84 per cent of the total employment is generated by formal-sector manufacturing units employing more than 100 persons, as shown in Figure 3.13. The MSMEs constitute 78 per cent of the total number of manufacturing units in the formal sector, whereas the total employment created by these units is only 16 per cent of total formal-sector employment. On this basis, estimated employment in the informal and the formal manufacturing sector MSMEs accounts for 1.35 million workers.

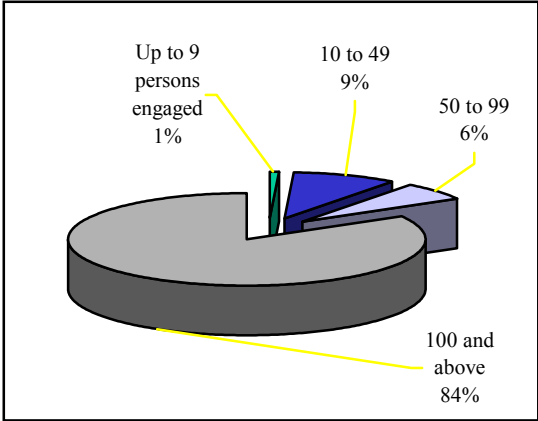
<sup>12</sup> These include manufacturing concerns registered with the Labour Welfare Department under the Factories Act 1934. Government defence operations and manufacturing facilities are excluded.

**Figure 3.12: Formal manufacturing establishments by size, 1995-96**



Source: Census of Manufacturing Industries, 1995-96.

**Figure 3.13: Formal manufacturing employment by establishment size, 1995-96**



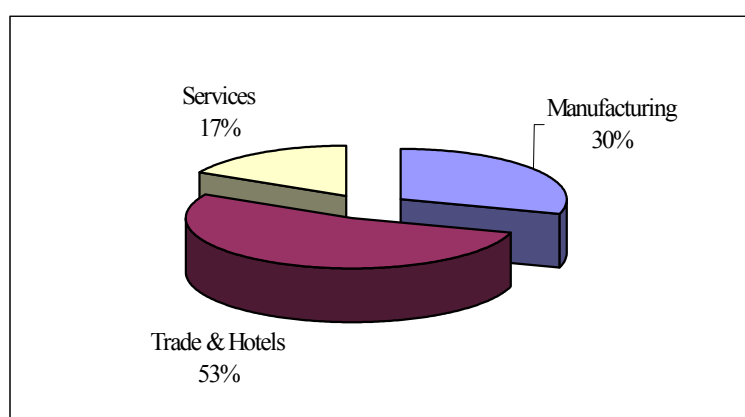
Source: Census of Manufacturing Industries, 1995-96.

### 3.4 GDP and the MSME sector

As described in Section 3.2, MSMEs contribute significantly to overall employment figures, particularly in the non-agricultural sector. Further, the MSME sector in Pakistan is characterized by a high presence of micro enterprises. More than 95 per cent of these enterprises, regardless of sector, operate at the micro level (employing less than 10 workers). And, as micro enterprises are dominated by self-employed individual entrepreneurs, a main feature of these enterprises is their very small contribution to GDP. However, it must be emphasized that discrepancies and inconsistencies in existing data make it very difficult to determine the presence of MSMEs accurately. The difficulty is compounded by the varying methodologies used by surveys to determine the contribution of MSMEs to GDP.

To estimate the total contribution of MSMEs to GDP, three data sources have been analysed. The CMI 1990-91<sup>13</sup> is used to estimate the contribution of formal manufacturing sector micro, small, and medium-sized enterprises.<sup>14</sup> The SHMI 1996-97 is used for that of the informal manufacturing sector firms (micro and small) and the ISSMI 1992-93 is used for the services and trade/hotel sectors. As some of the data is as old as 1990-91, the contributions to GDP for 2000-2001 have been estimated by extrapolation.<sup>15</sup> Based on these estimates, Figure 3.14 presents the distribution of MSME GDP by sector.

**Figure 3.14: Distribution of estimated MSME GDP by sector, 2000-2001**



Note: Services include transport, finance and community services.  
Source: SMEDA, 2001.

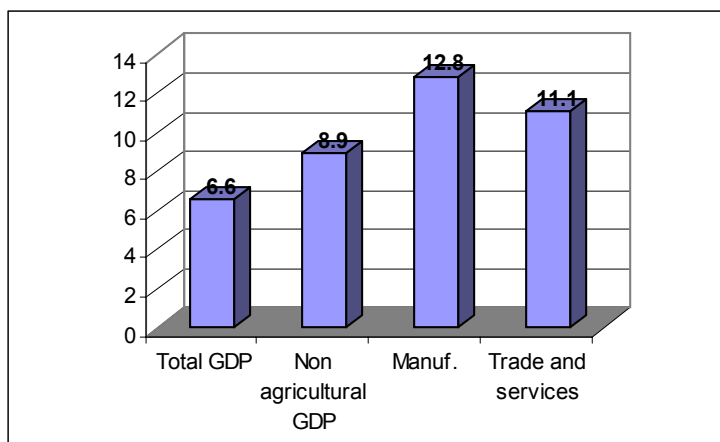
The MSME sector contributes around 7 per cent of the GDP, and 9 per cent of non-agricultural GDP. This low share is explained by the dominant presence of micro enterprises in all three sectors. As shown in Figure 3.15, although the contribution of MSMEs to total GDP is not very high, it still represents almost 13 per cent for the manufacturing sector and 11 per cent for the trade and services sector.

<sup>13</sup> No breakdown by employment size class was available in the CMI 1995-96.

<sup>14</sup> Manufacturing-sector enterprises employing 1-9 (micro), 10-49 (small) and 50-99 (medium) employees have been included.

<sup>15</sup> The manufacturing sector MSME GDP contribution has been estimated by extrapolating the data from SHMI-1996-97 and CMI 1990-91 at the manufacturing sector GDP average growth rate of 4.26%. In case of registered manufacturing firms the reported data has been extrapolated over a period of 10 years whereas the SHMI data over a period of four years. The MSMEs' contribution to GDP is estimated at Rs. 57 billion in the manufacturing sector. The growth average growth rate of services sector GDP from 1992-93 is also 4.25%, as is the case with manufacturing sector. On the basis of this if the data of ISSMI is extrapolated the contribution of MSMEs in Trade is Rs. 104 billion whereas that of MSMEs in services is estimated as Rs. 34 billion.

### 3.15: Estimated MSMEs' contribution to GDP by sector, 2000-2001 (%)



Source: SMEDA.

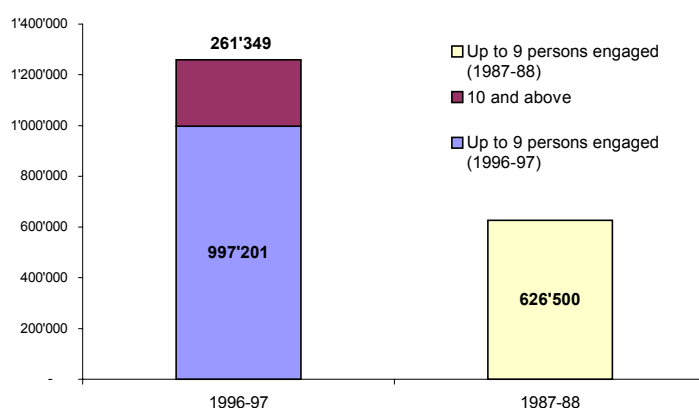
Some studies have estimated the share of MSMEs in GDP at a much higher level. In this context, it is interesting to note that it has recently been estimated that the “undocumented economy” accounts for 55 per cent of the GDP of Pakistan (Quereshi et al., 1977). Depending on the methodology, the size of enterprises covered and the varying results obtained in surveys, figures on the share of MSMEs in GDP may be either under- or overestimated.

Given the current stage of development in Pakistan and present indications, the key driver is rapid employment creation with low levels of investment. A keynote of the MSME sector is its employment-generating capacity.

### 3.5 Trends of employment in MSMEs

The growth of employment in manufacturing micro enterprises in Pakistan can be estimated using the findings of the Survey of Small and Household Manufacturing Industries (SHMI) conducted in 1987-88 and 1996-97. Figure 3.16 shows that, according to SHMI data, employment in micro enterprises increased by almost 60 per cent (from 627,000 to almost 1 million persons) over this 10-year span, with a similar growth (also 60 per cent) in the number of enterprises. Unfortunately, there are no data available on the employment growth in small and medium-sized enterprises, or in MSMEs in the trade and services sectors. In addition, due to the absence of longitudinal data sets by enterprise size, the actual employment creation in MSMEs cannot be estimated.

**Figure 3.16: Workers in informal manufacturing enterprises by size class. 1987-88 and 1996-97**



Source: Survey of Small Household and Manufacturing Industries, 1987-88; 1996-97.

Gallup carried out a small-scale survey in 2001<sup>16</sup> to capture the most recent pattern of employment growth in selected MSMEs. Table 3.4 shows that 36 per cent of the surveyed enterprises increased their number of workers; 43 per cent neither increased nor decreased their workforce; and 14 per cent decreased their workforce.

**Table 3.4 Employment growth in surveyed MSMEs, 1999-2001**

	Permanent full-time (%)	Permanent part-time (%)	Temporary (%)	Total (%)
Micro	7.4	20.2	22.7	12.8
Small	18.5	0.0	25.0	17.5
Medium	25.0	-	-100.0	0.0
Total	16.3	9.3	7.8	13.7

Growth rates of the average employment in enterprise size classes

Source: SMEDA/Gallup MSE Survey, 2001.

In terms of the actual number of employees, the total increase from 1999 to 2001 was 14 per cent. The highest increase (18 per cent) was in small enterprises, mainly due to an increase in the number of temporary employees. Employment in micro enterprises also increased through a balanced increase in part-time and temporary employees. In medium enterprises, the employment level remained stagnant, due to a drastic decrease in temporary employment. However, permanent full-time employment in medium firms increased by almost 25 per cent.

<sup>16</sup> Gallup/BRB Survey of 333 Owners/Managers of MSMEs in the trade, services and manufacturing sectors. This survey defined micro units as 2 to 9 workers; small units as 10 to 34 workers; and medium units as 35 to 49 workers. See also Gallup/BRB Pakistan (forthcoming).



### 3.6 Employment management and enterprise practices

#### 3.6.1 Workers profile and job quality

Most employees in the MSME sector are employed full-time.<sup>17</sup> According to the SMEDA/Gallup MSE Survey, more than 60 per cent of micro and small enterprise workers and 100 per cent of workers in medium enterprises were employed full time. Reliance on temporary employees was found to be very restricted in micro and small firms. In the medium-sized firms surveyed, no employees worked on a part-time or a temporary basis.

The low participation of women in the MSME sector is similar to the gender picture for the total labour force of Pakistan. Female employment was almost 17 per cent of total employment in the enterprises surveyed by Gallup. A large majority of enterprises employ no women: 76 per cent of the sample had no permanent full-time female employees. The percentages for part-time and temporary employment for women were even higher, at 94 and 97 per cent respectively. The reasons for low female employment in the MSMEs are not very different from women's low participation in overall economic activity. Due to prevailing socio-cultural norms, women in most parts of Pakistan are discouraged from working formally in industrial, trade and services sector activities.

**Table 3.5: Conditions of work or benefits provided by MSMEs to workers (%)**

Provision	Total	Sector			Enterprise size		
		Trade	Services	Manufacturing	Micro	Small	Medium
Drinking-water facilities	76	65	77	87	66	83	95
Safer working conditions	72	65	71	80	63	78	90
Salary increase	66	53	66	79	51	78	92
Toilet facilities	62	43	69	71	48	70	92
Productivity incentive	56	41	57	67	39	72	74
On-the-job training	38	16	44	52	30	47	44
Written contracts of employment	20	12	19	28	6	31	44
Transport for workers	16	9	19	21	5	24	38
Maternity/paternity leave	15	2	26	15	8	21	26
Off-the-job training	9	1	14	12	2	17	13
Pension/insurance scheme	8	2	6	16	1	12	26

Source: SMEDA/Gallup MSE survey, 2001.

Table 3.5 indicates the overall conditions in which workers operate in Pakistan, including work environment, remuneration, social coverage such as pension and insurance, and job security. The practice of written contracts of employment in the MSMEs surveyed by Gallup is rare: only 20 per cent of respondents provide employees with this type of contract, mainly in medium-sized enterprises which are also registered with the labour department. In the micro sector, enterprise owners generally employ on verbal contracts, with only 6 per cent providing contracts in writing. Employee pension or insurance schemes are also very low; only 8 per cent of respondents provided any social coverage or benefits.

<sup>17</sup> Eighty per cent of employees in micro enterprises in the manufacturing sector are full-time employees, according to SHMI 1996-97.

On the other hand, there is wider provision of salary increases, safer working conditions and productivity incentives. It would be incorrect to assume that the salary increase is a norm in this highly competitive sector. Monetary benefits are strictly tied to performance and productivity. The SMEDA/Gallup MSE Survey found that almost 56 per cent of enterprises in the MSME sector provided a productivity incentive to employees.

It is generally assumed that human resource development in MSMEs is through the system of *Ustaad-Shagird* (apprenticeship); young apprentices are employed on meagre salaries but provided with on-the-job training. However, according to the SMEDA/Gallup MSE results, very few apprentices are hired (no apprentices were reported in small and medium enterprises, with a negligible proportion hired in micro enterprises.<sup>18</sup> Equally, off-the-job training is rarely provided to employees.

An important aspect of conditions of work is observance of the labour code, which clearly states that the working hours should not exceed 8 hours a day. In the MSME sector, the average shift worked is 12 hours. Employees are not paid overtime as salaries are based on a 12-hour norm.

### **3.6.2 Owner/manager profile**

It is generally assumed that the majority of MSME owners/managers have little formal education and acquire their skills or know-how in a family-owned or operated business. However, according to the SMEDA/Gallup MSE Survey, 2001 only 4 per cent of respondents had no formal education;<sup>19</sup> 38 per cent had university education and 35 per cent had post-secondary education. Only 3 per cent of respondents had received any vocational training. Interestingly, the number of women entrepreneurs with university education was much higher than that for men entrepreneurs.<sup>20</sup>

As Table 3.6 shows, only 22 per cent of respondents had entered family-owned or operated enterprises. The vast majority were start-ups (67 per cent of respondents had started their own micro enterprises in the SMEDA/Gallup MSE Survey). Family-owned businesses were also operating in the sector but only to a limited degree. Women entrepreneurs (83 per cent of respondents) established a start-up based on their own independent decision, which is significantly higher than the number of men respondents. This could result from a sampling bias favouring women from urban areas, who enjoy considerable economic independence to take business initiatives, in comparison with the large majority of women in rural areas.

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<sup>18</sup> Between 97-100 per cent of enterprises had no apprentices (Gallup/BRB survey).

<sup>19</sup> The literacy rate in Pakistanis is 46 per cent. Those who can write their name and read Urdu are considered to be literate.

<sup>20</sup> This may be because the sample of women entrepreneurs was mostly taken from urban areas.

**Table 3.6: Type of business initiatives taken, according to enterprise size (%)**

How your business started	Total	Enterprise size		
		Micro	Small	Medium
As a family-owned business	22	19	24	26
On my own initiative	61	67	55	54
Friend or relative	14	10	17	21
Bought as a running business	3	4	2	0
No response	1	1	1	0

*Source: SMEDA/Gallup MSE Survey, 2001.*

In most developing countries unemployment and poverty are major factors in business start-up, particularly in micro enterprises — commonly known as “survivalist enterprises”. Individuals managing these businesses immediately switch as soon as they find better opportunities. The majority (68 per cent) of respondents to the SMEDA/Gallup MSE Survey stated that their main motivation to start a business was that they “wanted to be their own boss”, with the highest proportion of these respondents were in micro enterprises. Only a very small number of respondents stated that they had started their business because they were either unable to find employment or their previous employment had terminated — an indication that the entrepreneurial spirit may be a basic motivator in the initiative and risk-taking involved in business start-up.

### **3.6.3 Type of business, location and operation**

Household enterprises constitute a significant proportion of micro and small enterprises in Pakistan. According to the SHMI 1996-97 data, of a total of more than 400,000 micro-level manufacturing establishments, 38 per cent were household<sup>21</sup> manufacturing concerns. In the SMEDA/Gallup MSE Survey, 49 per cent of enterprises operated a sole business site and 33 per cent shared a business site. Only 12 per cent worked as household businesses. The proportion of household businesses was high in micro enterprises (20 per cent) and in enterprises managed by women (35 per cent). These results are consistent with the SHMI estimates. The data imply that, for the majority of owners or managers of MSMEs, their business is their source of income and cannot be considered as a “side” business. In the majority of enterprises surveyed, the entrepreneur owns the premises in which the business operates (62 per cent of medium enterprises, 57 per cent of small and 44 per cent of micro enterprises). This suggests that as the enterprises grow in size and acquire a formal structure, they use their increased financial resources to build up capital investments and assets.

In sum, the characteristics described above indicate that the MSMEs are fully functional, independent business entities generating full-time employment. There is evidence that these enterprises, like the large-scale firms, experience growth. Employment for women is extremely low in these enterprises, but this is not exclusively associated with the MSME sector; female labour force participation at a national level presents a dismal picture. Depending upon resources, the MSME labour force is managed by the performance/reward incentive system. Employees do not enjoy the benefits of job security in the form of formal contracts or the benefit of social security but, given their resources, employers try to provide a safer working environment. The SMEDA/Gallup MSE Survey found that, in most cases, respondents had initiated and operated their enterprises with well-devised methods of

<sup>21</sup> If the head and/or members of a household are engaged in manufacturing activity in (or around) the house they occupy, this household is defined as a ‘manufacturing household’ in the SHMI survey.

planning — in their initial response to market demand and also from their wish to “remain their own boss”.

Laws and regulations covering the incorporation of a business entity, as well as the procedures for operation of different corporate structures within Pakistan are set down in the Companies Ordinance Act 1984. The roles of the different departments that enforce the regulatory framework and the features of the Companies Ordinance Act with a direct impact on MSMEs are discussed in Part 4.

## 4. The regulatory framework on business entity, structure and operation

The Securities and Exchange Commission of Pakistan (SECP) defines and enforces the regulatory framework on business entity and enterprise operation in Pakistan. The rules pertaining to business structures are stipulated in the Companies Ordinance, 1984 and are summarized below.

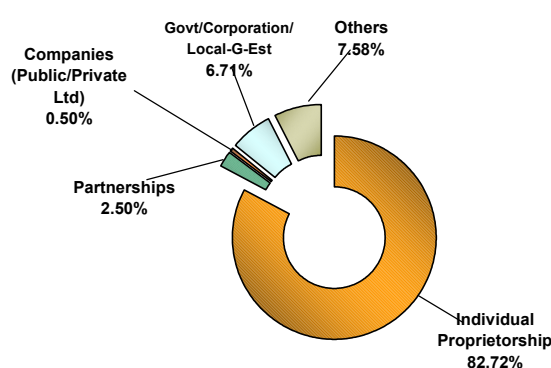
### 4.1 Types of business structure

The types of business structures provided by law are:

- sole proprietorships
- partnerships (registered and unregistered)
- companies (private or public)
- cooperative societies
- not-for-profit associations (trusts, etc.)

The laws on business entity and structure in Pakistan are not applicable to all enterprises across-the-board. Small-scale entrepreneurs opt for the loose structure of sole proprietorship, for reasons of cost, low complexity and ease of compliance with regulations. Enterprises with less than 10 workers are not required to register with government departments. The Census of Establishments 1988<sup>22</sup> found that almost 83 per cent of all enterprises in Pakistan were sole proprietorships, with only 0.5 per cent registered companies, as shown in Figure 4.1. The majority, especially the micro-sized enterprises, prefer to avoid regulatory obstacles. However, this has a negative impact on their access to finance, given that the SECP which regulates the incorporation of companies is also in charge of regulating the capital markets.<sup>23</sup>

*Figure 4.1: Enterprises according to type of business structure, 1988*



Source: *Census of Establishments, 1988.*

<sup>22</sup> Of the enterprises surveyed, 97 per cent had 1 to 9 workers, i.e. were micro enterprises.

<sup>23</sup> In this context, SMEDA is working with the Asian Development Bank to explore other means of financing for SMEs, particularly venture capital.

The findings of the SMEDA/Gallup MSE Survey 2001 presented in Table 4.1 confirm that the share of companies and registered partnerships is much higher in the small and medium enterprise segments than in the micro enterprise segment, where almost 95 per cent of enterprises operate as sole proprietorships or unregistered partnerships.

**Table 4.1: Type of business structure in MSMEs (percentage)**

Type	Total	Sector of business			Size of business		
		Trade	Services	Manufacturing	Micro	Small	Medium
Sole proprietorship	72	77	70	69	89	58	46
Partnership registered	12	12	10	14	6	16	26
Partnership unregistered	9	9	9	8	5	13	10
Private company	6	2	7	7	1	11	10
Cooperative society	0	0	1	0	0	1	0
Other	1	0	2	1	0	1	8

Source: SMEA/Gallup MSE Survey, 2001.

**Sole proprietorships** and **unregistered partnerships** are entities that do not legally require any registration or prior approval from a government department or agency. There are no formal reporting requirements based on external or third-party audits. However, this does not imply that these enterprises are not obliged to comply with labour, tax and other regulations. Unlike private companies, they enjoy the benefit of income tax concessions<sup>24</sup> and low fixed costs because their documentation requirements are very low. Annex 2.1 shows the procedure necessary and the fees incurred for a **registered partnership**. In this case, the services of a lawyer are optional.

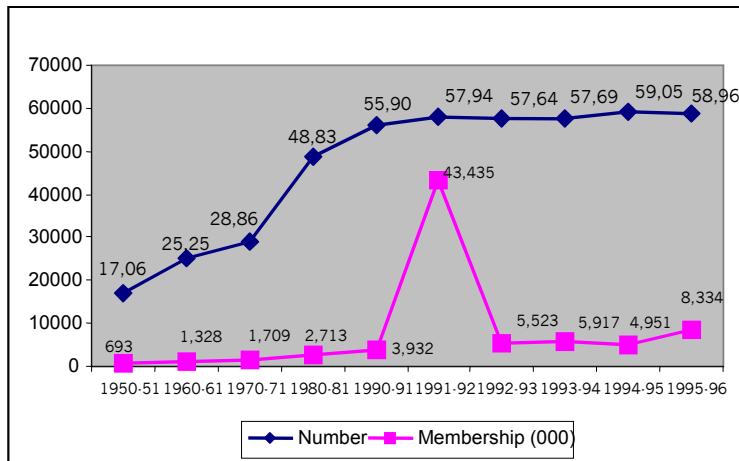
**Private companies** incorporated under the Companies Ordinance, 1984 are registered with the SECP. Annex 2.2 presents an overview of company registration procedures and the fees incurred. Registration obliges companies to document all business activities and to maintain a system of accounts, with a third-party audit each year. This documented track record of company performance allows improved access to formal sources of credit. Private companies do not enjoy any tax concessions but are given priority in the Self-Assessment Scheme of Income Tax,<sup>25</sup> which significantly reduces the administrative interaction with government departments. Similarly, incorporated enterprises are given preference by the Central Board of Revenue for faster processing of claims for tax refunds.

A **cooperative society** (under the Co-operative Societies Act, 1925) is usually formed for a commercially viable activity, where the arrangements provide the mechanics for collective efforts and distribution of profits among members. Internationally, this participatory development model has received wide recognition as a structure that particularly enhances the access of MSMEs to formal financial sources of credit. Other types of cooperatives include buyers cooperatives and marketing cooperatives. However, a number of investment cooperatives (mainly in the non-agricultural sector) in Pakistan misappropriated the funds of small savers in 1992-93, with a consequent decline in the formation of new cooperatives, as Figure 4.2 shows.

<sup>24</sup> Progressive income tax is levied on partnerships and proprietorships, i.e. tax is paid on slabs of income earned and is considerably lower than that paid by companies, which are taxed on fixed income at a higher rate of taxation.

<sup>25</sup> This scheme helps firms in the filling-out of income tax returns and considerably lessens the amount of time spent in dealing with tax-collecting agencies. Private companies are eligible to access the facility by showing a 10 per cent increase in their previous year's income. Proprietorships and partnerships are eligible only with a 20 per cent increase in performance.

**Figure 4.2: Growth of cooperatives in Pakistan**



Source: FBS, *Fifty years of Pakistan Statistics, 1947-1997, 1998*.

Most micro enterprises, with a large presence of self-employed individuals, operate as sole proprietorships with no legal requirements for compliance. Even in the case of partnerships, the tendency is to prefer unregistered partnerships, again with no legal compliance requirements. The cost of compliance increases when firms are incorporated as companies because of associated professional costs (legal advisor; financial auditors).

#### 4.2 Intellectual property laws

While laws to regulate trademarks, copyrights and patents have been formulated, their enforcement and implementation in Pakistan is very weak. In the context of MSMEs, very few entrepreneurs are aware of the existence of intellectual property laws; even fewer take concrete steps for implementation and compliance. According to the SMEDA/Gallup MSE Survey, 2001 only 9 per cent of MSMEs are registered with the Registrar of Trademarks and Copyrights and 5 per cent with the Registrar of Patents. Table 4.2 shows that compliance with intellectual property laws relates directly to the size of an enterprise (33 per cent of medium-sized enterprises versus only 3 per cent of micro enterprises).

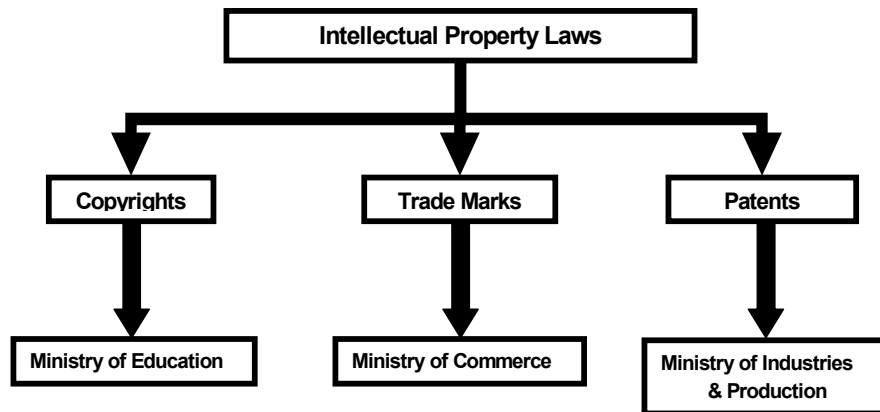
**Table 4.2: Registration of intellectual property by MSMEs (percentage)**

Type of intellectual property registered	Total	Micro	Small	Medium
Trademarks	9	3	10	33
Patents	5	0	6	18
Copyrights	9	3	10	33

Source: SMEDA/Gallup MSE Survey, 2001.

In developed economies, intellectual property laws are regulated under a single umbrella organization to reduce the regulatory impediments that discourage entrepreneurs from compliance with regulations. In Pakistan, all three areas (copyrights, trademarks, patents) are managed separately by different federal ministries, as shown in Figure 4.3.

**Figure 4.3: Administrative set-up of intellectual property laws in Pakistan**



Source: SMEDA

A glance at Annex 2.3 on copyright registration procedure, Annex 2.4 on trademark registration and Annex 2.5 on patents suffices to understand the to-ing and fro-ing between government departments required to comply with regulations. Waiting and processing time are additionally prolonged by problems of understaffing in the three ministeries handling intellectual property registrations.

Although prescribed time limits are set for processing, they are not met and the lengthy delays entailed are clear in the following two examples.

- The prescribed time-frame for copyrights registration as stipulated in the Copyrights Ordinance, 1962 is 30 days but in practice the process requires anywhere from 5-12 months on average.
- The prescribed time-frame for patent registration is 18 months. In practice, this process can take up to 2 years.

In the Trademark Act, 1940 no time-frame for the registration process is stipulated, giving a great deal of discretionary powers to government officials. It can take up to a year for a business to obtain an authentic trademark.

The lack of awareness and willingness to protect copyrights can be gauged from the fact that only 2,500 applications are received by the Registrar of Copyrights each year. As Annexes 2.3, 2.4 and 2.5 show, the costs of compliance are as low as PKR 2,500, but the time, effort and paperwork involved are considerable.

### **4.3 Copyright infringements**

Copyright laws, if strictly enforced in Pakistan, would affect those micro enterprises whose earnings depend heavily on the trade in pirated or counterfeit video products. It is difficult to gauge how many informal jobs are generated in these retail and service sector enterprises. Licensed video films distributed in Pakistan are copied and sold in hundreds of video rental outlets. This trade in pirated videos is a main source of earnings for such enterprises, but has a negative effect on the earnings and profitability of licensed distributors.

Similarly, the manufacture of pirated computer software with world-renowned brand names is generating considerable employment in the manufacturing sector. A large number of



micro entrepreneurs operate outlets selling these pirated software versions, a trade which also serves as a means of subsistence for an unestimated number of households.

Here again, the laws dealing with intellectual property rights and corporate identity of an enterprise are not enforced across-the-board. The legal framework associated with business identity under the Trademark Act is widely used in the retail, service and manufacturing sector. Micro and small enterprises rarely apply for copyright and registration of patents, while large- and medium-scale enterprises, including multinationals, comply with these regulations as standard practice. However, it is difficult to ensure the effective implementation of these laws among MSEs. This point is amply illustrated by the widespread availability of pirated software in Pakistan. The unsuccessful attempts of two industry giants (Microsoft and Oracle) to take effective legal action, with the assistance of local administrations, to stop the illicit sale and distribution of pirated software delineate the status of implementation and enforcement of these laws.

Part 5 outlines labour legislation and looks at labour policy in relation to the employment environment it creates. A capsule examination of the Factories Act, 1934 highlights an example of good practice in the Punjab and illustrates the current situation in Pakistan with regard to non-compliance with regulations and its relation to misuse of discretionary powers in the MSME sector.

## **5. Labour Policy**

While the trade and fiscal policy is announced annually (see Section 2.2.2) labour policies have been formulated far less frequently than any other in Pakistan's policy framework. The First Labour Policy was announced in the 1970s, the next and most recent in 2001 — a gap of almost three decades. During this period, the labour force has increased enormously. Developments in minimum wages, working hours and standards, technological changes and even the global economy have not been given due importance through up-to-date policy reform.

### **5.1 Policy formulation**

The Ministry of Labour, Manpower and Overseas Pakistanis is mandated to perform the function of policy formulation regarding labour administration, labour force planning and employment promotion, in close coordination with the provincial governments. The Ministry of Labour uses a tripartite approach, incorporating the views of representatives of employers, workers and government.

The main areas of focus for a successful labour policy are (i) strategic government management of labour so that qualified and trained labour may be supplied to meet industry demands and (ii) the provision of fundamental rights for workers and employers.

The following departments fall under the jurisdiction of the Ministry of Labour, Manpower and Overseas Pakistanis:

- Workers Welfare Fund
- Directorate of Labour Welfare
- Employees Old Age Benefits Institution
- Employees Social Securities Institution
- Bureau of Emigration and Overseas Employment
- Directorate of Workers Education
- National Industrial Relations Commission
- National Training Bureau

#### **5.1.1 The forgotten MSME sector**

No specific measures or targeted action plans for MSMEs are mentioned in the Labour Policy 2001, despite the high share of employment in this sector. Although a move to encompass the informal sector in the ambit of labour regulations was announced in the Labour Policy 2001, the coverage of policy initiatives is still limited to important urban centres. Micro entrepreneurs in the rural areas thus lack awareness of the regulatory framework and various incentive packages and schemes on offer.

Both the Employees Old Age Benefit Institution and the Employees Social Securities Institution have recently reduced the minimum enterprise size for compliance from 10 to 5 workers, with the option of voluntary registration. This is the first step in the process of increasing the scope and coverage of labour regulations in Pakistan.

Two major factors hindering compliance are the time consumed in government interaction and the vast number of laws to be complied with. For example, compliance with one regulation usually obliges businesses to comply with a whole range of associated laws.

This tends to result in entrepreneurs opting to remain in the informal sector, or underreporting their number of workers.

To improve this situation, the government lately announced a self-assessment scheme under which the MSEs are exempt from labour inspections for 3 years. If implemented properly, this can provide enough time for enterprises to upgrade to the formal sector and comply with labour regulations. This would also save entrepreneurial time for more productivity-related activities.

## **5.2 Labour legislation**

At the provincial level, federal laws are translated into provincial rules for the proper implementation of the Labour Code. Many laws have overlapping functions. Considerable work has been done to rationalize these laws in order to achieve an efficient and effective labour code. To achieve accountability and enforce these laws, the labour courts and tribunals play a crucial role. The following federal laws are currently prevalent in Pakistan:

- The Industrial Relations Ordinance 1969
- The Industrial and Commercial Employment Ordinance 1968
- The Payment of Wages Act 1936
- The Minimum Wages Ordinance 1961
- The Apprenticeship Ordinance 1962
- The Factories Act 1934
- The Workmen's Compensation Act 1923
- Provincial Social Security Ordinance, 1965
- The Shops and Establishments Ordinance, 1969
- The Companies Profits (Workers Participation) Act, 1968
- Workers Welfare Fund Ordinance, 1971
- The Fatal Accidents Act, 1855
- The Employers Liability Act, 1938
- The Employment of Children Act, 1991
- The Road Transport Workers Ordinance, 1961
- Workers Children (Education) Ordinance, 1972
- The Employees Old Age Benefits Act, 1976
- Control of Employment Ordinance 1965
- Employees Cost of Living (Relief) Act, 1973
- Disabled Persons (Employment and Rehabilitation) Ordinance 1981
- West Pakistan Maternity Ordinance, 1958
- The Employment (Record of Services) Act, 1951
- The Bonded Labour System (Abolition) Act, 1992
- Professional Tax on Professionals, Traders, Occupations and Employment

One of the most pressing issues for the labour policy platform is the cost of compliance — in terms of both time (spent dealing with various compliances issues with various departments) and money. The general consensus is that there are far too many labour laws in Pakistan. Especially for the micro and small sized firms, obligatory compliance would be a considerable problem. But, as mentioned earlier, micro enterprises are exempt from several of the labour laws applied to business entities with 10 or more workers.

To illustrate various attributes of the Labour Code, labour laws have been separated into various “types” as follows.

### 5.2.1 *Collective bargaining power of employees within the MSME sector*

Many employers consider trade unions as a weakening factor for their enterprise. Although the labour legislation in Pakistan does not stipulate a minimum size of the enterprise for the creation of a trade union, many industrial units are broken into smaller ones so as to avoid the “critical mass” of workers required for trade unionism. Moreover, awareness levels are very low, especially in the smallest enterprises. Workers do not know that they are protected under the law. Furthermore, fines for employer non-compliance are relatively low and do not serve as a deterrent.

As these laws relate to the fundamental right of collective bargaining and trade union formation, a more stringent approach is called for. For example, contractual workers are not covered under the Industrial Relations Ordinance in Pakistan. How the voting terms are defined has left a loophole for employers to avoid the law and to employ workers on a contractual basis. This is observed particularly in the medium-sized sector, where employer awareness is generally higher than in the micro and small enterprises.

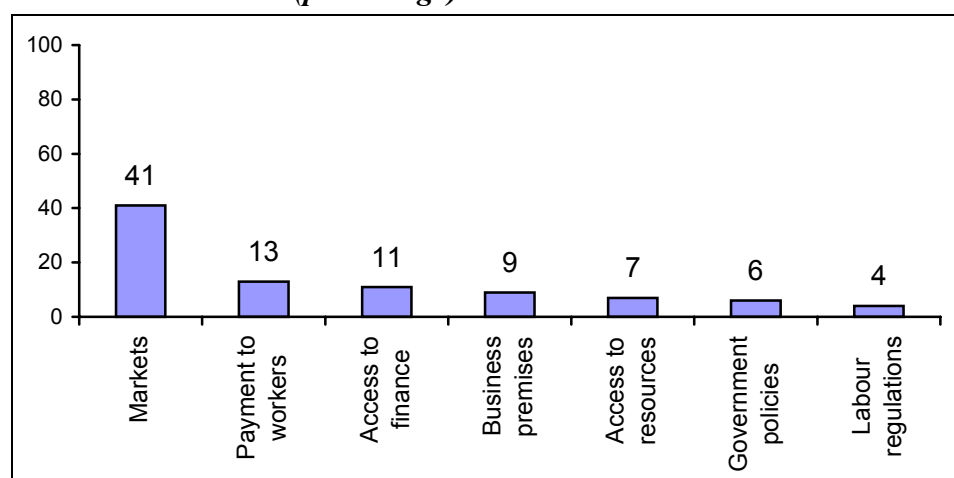
### 5.2.2 *Job quality*

The laws relating to employment quality generally allow the enforcement of principles of good practice and the fundamental rights of workers. Employment quality indicators include working hours, wages, benefits associated with illness, accidents, old age, maternity and conditions of work (see Part 3, Table 3.5).

The SMEDA/Gallup MSE Survey, 2001 results presented in Part 3 illustrate the priority listing employers give to employment standards in the workplace. Issues such as written employment contracts, maternity leave and pension schemes have a low level of awareness and importance.

As Figure 5.1 shows, many business owners tend to base their decisions relating to employment standards and number of employees on market trends. Government policies rated very low (only 6 per cent of the sample enterprises) as a factor influencing employment levels.

**Figure 5.1: Key factors influencing employment decisions in surveyed MSMEs (percentage)**



Source: SMEDA/Gallup MSE Survey, 2001.

The importance of government policy in employment decisions increases in relation to enterprise size. Medium-sized firms gave it their second highest priority after market trends, whereas within the micro sector the main issue was access to finance. Market factors, by contrast, were mentioned as the most important factor regardless of the size class of the enterprise.

Certain categories of workers are excluded from the coverage of labour laws in Pakistan, such as daily waged workers and contract labour, who represent a considerable share of MSME employment. Likewise, labour standards do not cover workers in micro enterprises and in the informal sector. For these reasons, the scope of these laws begins at a small scale and above.

The rate of female participation in the various categories of employment is very low: 74 per cent of the sample enterprises had no female permanent full-time employees. The virtual absence of female apprentices in the MSMEs should also be noted in this context. (See also Section 5.5, for a gender perspective.)

### **5.2.3 Minimum wage regulations: Lack of awareness and monitoring**

The payment of minimum wages contributes to poverty alleviation. The awareness of both employers and employees is crucial for the enforcement of minimum wage regulations. The infrequency of labour policy reforms and the fact that the minimum wage does not increase automatically to compensate for the loss in purchasing power due to inflation should be noted in this regard. The Labour Policy 2001 increased the minimum wage by 22 per cent to PKR 2,500. It should also be noted that according to the MSME Survey, 34 per cent of the respondents cited labour costs as the reason for not hiring more workers.

Many workers in Pakistan earn less than the minimum wage. In 1998, 8.73 million workers — 24.3 per cent of total employment — were earning below PKR 1,500 per month. In the same year, the monthly minimum wage was PKR 2,050.

Monitoring minimum wage laws in micro enterprises or in the informal sector is extremely difficult, given the large number of enterprises and the lack of awareness among both employers and employees.

## **5.3 Employee welfare and social security contributions**

The social welfare system in Pakistan is inadequate because of a number of constraints within the economy and in policy implementation. The following laws and regulations deal with social welfare:

- Employee's Old Age Benefit Act, 1976
- West Pakistan's Maternity Benefits Ordinance, 1958
- Workers' Children (Education) Ordinance, 1972
- Workers' Welfare Fund Ordinance, 1971
- Provincial Social Securities Ordinance, 1965
- Company Profits (Workers' Participation) Act, 1968

These laws all relate to job quality, in that their main function is to provide benefits to the workforce. It is every employer's legal responsibility to pay social security contributions according to specific regulations. The laws provide details on the method of assessment and

collection of these labour levies from the employer. Many enterprises, especially in the MSME sector, avoid paying social security contributions by remaining in the informal sector.

Table 5.1 shows the average contributions that a small manufacturing enterprise in the formal sector is required to pay.

**Table 5.1: Social security contributions paid by an individual manufacturing establishment<sup>26</sup>**

<b>Enterprise data</b>	
Number of employees	49
Number of employees earning wages < PKR 3,000 (i.e. PKR 1,500)	20
Number of employees earning wages = or > PKR 3,000	29
Annual turnover	15,000,000
Gross profit (20% of turnover)	3,000,000
Income tax (35% of gross profit)	1,050,000
Profit (profit after income tax deducted)	1,950,000
<b>Individual rates of contributions (per month)</b>	
Employees Social Security Institution	7% of 1 <sup>st</sup> PKR 3,000 wage
Employees Old Age Benefits Institution	5% of 1 <sup>st</sup> PKR 3,000 wage
Workers' Children Education Fund (PKR)	100 per worker
Employees Cost of Living (Relief) allowance (PKR)	25 per worker
- for workers receiving monthly wages up to PKR 1,500 (PKR)	40 per worker
Professional tax (PKR)	5,000
<b>Contributions</b>	
Employees Social Security Ordinance, 1965	98,280
Workers' Children (Education) Ordinance	4,900
Employees Old Age Benefits Act, 1973 (in PKR)	70,200
Employees Cost of Living (relief) Act, 1973 (in PKR)	24,300
Professional Tax (in PKR)	5,000
Contributions to be paid annually (before WWF contribution)	202,680
Workers' Welfare Fund Ordinance, 1971	39,000
<b>Total contributions to be paid annually (in PKR)</b>	<b>241,680</b>
<b>Contribution as % of annual turnover (before WWF contribution)</b>	<b>1.4%</b>
<b>Net profit (after income tax and WWF contribution)</b>	<b>1,911,000</b>
<b>Contribution as % of annual turnover (after WWF contribution)</b>	<b>1.6%</b>

Note: WWF = Workers' Welfare Fund. PKR 60 = US\$1.

Source: SMEDA.

In this example, the manufacturing enterprise employs 49 workers — the average size of a manufacturing enterprise in the formal sector, according to the Census of Manufacturing. According to the same source, the average turnover of an enterprise of this size is PKR 15

<sup>26</sup> Based on a hypothetical manufacturing unit of 49 employees.

million. Gross profit is estimated at 20 per cent. After deducting income tax at the rate of 35 per cent and Workers' Welfare contributions, the net profit is PKR 1,911,000.

Workers' Welfare Fund contributions are 2 per cent of profits. Given that many employers conceal their profits from the authorities, Table 5.2 shows contributions including and excluding welfare fund contributions. Companies that contribute to the Workers' Welfare Fund are Public Limited Companies, especially those listed on the stock exchange. As their profits are announced publicly, they pay the mandatory contributions. However, within the SME sector, the majority of manufacturing enterprises are sole proprietorships or partnerships, with a sprinkling of private limited companies. These looser structures allow for greater leeway in under-reporting.

The cumulative contribution not including workers' welfare fund corresponds to 1.4 per cent of turnover. The total contribution for a manufacturing concern employing 49 employees with PKR 15 million turnover is 1.6 per cent. Employers pay seven different social security contributions. The decision to register largely depends on whether or not the employer will benefit financially from becoming formal.

Between 1996 and 1999, the labour force has increased by approximately 9 per cent. During the same period, the number of insured workers in the Employees' Social Security Institution (ESSI) decreased by 1.15 per cent. One of the reasons for the decrease may be a general lack of confidence (on the part of employees and employers) in the quality of benefits provided institutionally. Annex 3.1 presents the ESSI's performance indicators for 1996-97 and 1998-99.

In 2000, it became more efficient and the percentage of income spent on covering workers increased by 11 per cent from the 1996-99 percentage (see Annex 3.2). However, this improvement has yet to win over the confidence of industry.

The coverage of the ESSI was only 10.8 per cent of the total formal non-agricultural sector employment in 1996-97.<sup>27</sup> All micro enterprises that employ between 1 and 9 workers were until recently excluded from social security coverage. This has now been changed to include enterprises with 5 to 9 workers. Overall, the ESSI covers 1.93 per cent of the total employed labour force — a worrying illustration of the social welfare net in Pakistan. Steps are desperately required to encompass the formal micro sector, as this sector is the main source of employment.

A similar concern regarding the quantity and quality of the services provided by the social welfare system arises in relation to educational benefits. The government provides education to workers' children by collecting an annual fixed sum of PKR 100 from employers with 10 or more workers. This allows workers to educate one child free of cost. However, in the Province of Punjab for example, only 1.2 per cent of workers covered actually send their children to the workers' welfare schools. Annex 3.3 compares the income and expenditures of the Children's Education (CESS) scheme in recent years.

The principal organization for retired workers is the Employees Old Age Benefit Institution (EOBI), which pays cash benefits and pensions to covered workers who have been employed for 15 years or more and have reached the age of 60 for men and 55 for women.

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<sup>27</sup> Government of Pakistan, Finance Division, *Report of the Task Force on Labour Welfare Levies*, 2000.

Only those enterprises that employ 5 or more workers are required to contribute. (This limit was recently reduced from 10 to 5 workers.) Other enterprises can affiliate on a voluntary basis.

It is interesting to note that the labour force participation rate of the age group 55 and over has increased over the years, an indication of insufficient household incomes at retirement and inadequate social welfare benefits. The minimum pension is currently is PKR 630 per month. Before the announcement of the Labour Policy 2001, the minimum pension had been PKR 425 for eight years. Even after this increase, the minimum pension is still not adequate and well below the minimum wage of PKR 2,050 per month.

#### 5.4 Enforcement of labour policies

**Table 5.2: Frequency of inspections and registration with labour departments in MSMEs, 2000**

Labour Departments		Location		Size			Sector		
		Urban	Rural	Micro	Small	Medium	Trade	Services	Manufacturing
Total No.	333	201	132	167	127	39	102	124	107
Visited by Labour Department Official (%)	15	22	4	5	23	31	7	15	22
Registered at the EOBI (%)	14	22	2	3	21	36	6	15	21
Registered at the ESSI (%)	8	13	1	1	13	23	4	8	12

*Source: SMEDA/Gallup MSE Survey, 2001.*

The SMEDA/Gallup MSE Survey, 2001 provides empirical evidence on the frequency of inspection visits by officials from government authorities dealing with labour policies. As shown in Table 5.2, the number of visits increases with enterprise size, in line with legal requirements (registration is mandatory for enterprises with 10 or more workers). Only 5 per cent of the micro enterprises of the sample, but 21 per cent of the small enterprises and 31 per cent of the medium-sized enterprises had been inspected during the two years prior to the survey. Inspection visits were found to be more frequent in the manufacturing sector (22 per cent) than in the trade and service sectors (7 per cent). This may be due to the mandatory compliance with the Factories Act which particularly concerns manufacturing enterprises.

With regard to social security coverage, 86 per cent and 92 per cent of the sample MSMEs are not registered with the EOBI and ESSI respectively. Even the small and medium-sized enterprises, whose registration with social security offices is compulsory, report low levels of registration. This could be due to major under-reporting on the part of employers with more than 10 workers, as well as inefficiencies in labour department registrations. The coverage is especially low in rural areas, where only 1 per cent of the sample MSMEs are registered with the ESSI. The low coverage ultimately results in inadequate job quality in the form of underutilized welfare benefits, which should be provided by these institutions. Annex 3.4 charts the performance of the EOBI up to 1999.



## **5.5 The gender perspective**

Gender-related laws in Pakistan are generally unbiased and fair but the cultural environment in which they are implemented traditionally restricts the active participation of the women in the labour force. Only the agricultural sector offers roughly the same opportunities to women and men, given that the priority in the rural areas is to achieve a sustainable household income.

Within the regulatory framework of Pakistan, the rights of women workers are protected with regard to maternity benefits. However, while best practices abroad suggest that this benefit should be partly paid by government through subsidies, this is not the case in Pakistan and thus may result in employers preferring not to hire women. Moreover, according to the Factories Act 1934, no woman worker is allowed to work after 7 p.m. till 6 a.m. in a factory. Although the reason for having this clause is to provide extra protection to the female work force, it can act as an entry barrier for female workers. The extent to which these laws are applied and implemented among the MSMEs cannot be determined exactly, but it is likely that most small and medium-sized enterprises in the formal sector are forced to comply. Apart from maternity benefits, other laws relating to wages and working conditions accommodate the specific needs of women.

If laws are properly enforced and women are made aware of these laws and informed of their fundamental rights, this could have a positive effect on their participation rate. However, awareness of these laws is even lower in the MSME sector than in larger enterprises. Women tend to be employed only for specific “female” tasks such as embroidery or sewing.

## **5.6 Case study: The Factories Act 1934**

One of the main laws relating to specific standards and working conditions in the factory workplace is the Factories Act 1934. Its complexity makes it difficult to comply with and the cost of compliance is high for small-scale or cottage manufacturing enterprises, which are unaware of the number of provisions and are also burdened with financial constraints.

To facilitate compliance, one of the provisions of the Factories Act provides a 1-year exemption (to comply with the Act) to manufacturing concerns that employ less than 20 workers in the case of new purchase, modernization or expansion. This exemption is currently available in the province of Punjab at the discretion of the Labour Department. As it covers the micro enterprise sector and part of the small enterprise sector, it may result in a number of enterprises moving from the informal sector into the formal one. This time-bound exemption can be considered an example of good practice.

The lack of awareness of all standards laws increases the discretionary powers of government-appointed inspectors, often resulting in corruptive practices. In these instances, it is the MSME sector that is most vulnerable and more likely to be pressurized into bribe-paying, causing the sector’s growth to be seriously hampered.

**Table 5.3: Number of inspections under the Factories Act 1934**

Province	No. of inspection staff	Total number of registered factories	Number of factories inspected and number of inspections					
			One	Two	Three	More than three	Total	Not inspected
Punjab	---	4,248	2,795	487	441	361	4,084	164
Sindh	31	4,656	2,652	434	40	---	3,126	1,530
N.W.F.P	14	629	285	61	48	26	355	274
Baluchistan	9	287	167	---	---	---	167	120
Total	54	9,820	5,834	982	529	387	7,732	2,088

*Note: Figures are based on Table X of the report and do not coincide with the figures mentioned in the text.*

*Source: Ministry of Labour, Manpower and Overseas Pakistanis, Annual Consolidated Report on the functioning of labour laws in Pakistan during 1997.*

During 1997, the number of registered factories was 9,820, out of which 7,948 remained in operation during the year 1997. The number of reporting factories in the year 1997 was 2,205 as compared with 1,866 in 1996, with an increase in employment reported as 18.3 per cent. There tends to be an increase in the number of factories that are both registering and reporting.

As Table 5.3 shows, out of the 7,948 registered factories in operation, 7,732 factories were inspected by the labour departments across Pakistan during 1997. Of these 5,834 were inspected once, 982 were inspected twice; 529 were inspected three times and 387 more than three times, resulting in a total of 2,088 factories that were not inspected. This implies that 31.4 per cent of all factories were visited more than once.

Official visits under the Factories Act do not seem problematic for entrepreneurs, given that most enterprises receive only one visit. However, these data do not include unofficial visits. Moreover, these inspections only correspond to the Factories Act. In total, there are 10 to 12 standards acts that are enforced by the labour departments. The number of nationwide disputes against the Factories Act 1934 is low — a total of 110, all of which were recorded in Punjab.

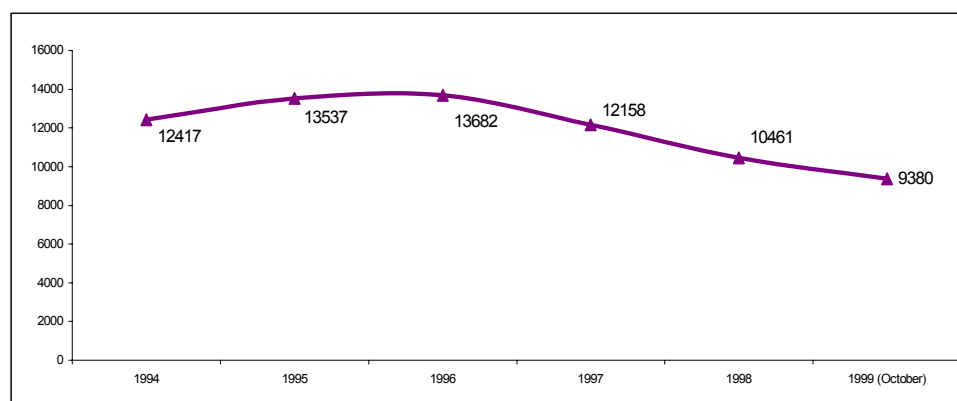
Unfortunately, the data on the implementation of the Factories Act are not disaggregated by enterprise size, which would allow more precise conclusions about its impact on the MSME sector.

### **5.6.1 Labour courts**

The labour judicial system is composed of Labour Courts and Labour Appellate Tribunals. In Pakistan the general tendency is to avoid the judicial system due to the costs and time involved. The micro and small sectors are ill-equipped to contest lengthy trials and mainly rely on out-of-court settlements.

The number of cases pending at the end of 1999 was 9,380 — a situation that has improved slightly over the years, as Figure 5.2 shows.

**Figure 5.2: Performance of labour courts: Number of cases pending at the end of each year, 1994-1999**



Source: Labour Division, Government of Pakistan, Report of the Commission for Consolidation, Simplification and Rationalization of Labour Laws, 2000.

## **5.7 Observations on labour policy implementation**

### **5.7.1 Awareness levels**

The foremost problem is the entrepreneurs' lack of awareness of existing labour regulations, which is in direct proportion to the size of the enterprise. The micro enterprises lack basic understanding about the prevailing labour laws. However, they are not required to comply with all regulations. Most enterprises on the threshold between 9 and 10 workers do not find it convenient to obtain basic information on compliance requirements. No consolidated effort has been made by government to inculcate a basic understanding of the labour laws, the steps required for compliance, the rights of owners/managers, or the correlation of enforcement with enhanced productivity and improved job quality.

### **5.7.2 Understanding the law: Language and literacy**

The Labour Code comprises more than 100 laws, including 30 or so regulations that are not sector-specific and are applicable across-the-board. It is published in English. To fully understand these laws, a comprehensive understanding of the English language is necessary. The literacy rate in Pakistan is as low as 45 per cent ("literate" defines those who can write their own name). An urgent step would be to translate the laws into Urdu so as to create wide-scale awareness.

### **5.7.3 Complexity of regulations**

Entrepreneurs cite the outdatedness of the laws as their main reason for non-compliance, but this is not the case. Despite its title, the Factories Act, 1934 has been revised and amended at various times to keep pace with developments in fire-fighting equipment or standards related to health. What daunts entrepreneurs is the overwhelming complexity of detail in the regulations and the number of necessary steps — for example, 136 steps are required for compliance with the Factories Act 1934. This is onerous for enterprises to implement, especially in the start-up phase.

### **5.7.4 Cost of compliance**

The general consensus is that the costs of compliance with labour levies are too high. Yet they are not excessive: for the average SME entrepreneur the total contributions based on various labour levies for an average size SME are not more than 1.5 to 2 per cent of annual turnover. However, even if these contributions were made, workers would not benefit greatly, due to dilapidated medical facilities and the limited coverage of pension schemes based on

labour levies. Moreover, by entering the formal sector, compliance with labour laws will not be the only issue to deal with. Being part of the documented economy, an enterprise can be traced by various other departments such as the tax department. Thus, many enterprises avoid registering and remain in the informal sector.

### ***5.7.5 Discretionary powers of labour departments***

In order to ensure the implementation of laws, government administrative machinery is given certain powers to evaluate and assess the level of compliance within a specific sector. No system can work without an effective implementation mechanism. The problem arises when entrepreneurs have only a limited understanding of their rights, which can result in misuse of power by labour department inspectors — ultimately resolved by directly paying the government official rather than contributing towards the Exchequer.

The perception of entrepreneurs is that the government departments are corrupt and that interface with government officials is problematic. A monitoring system of third-party private-sector compliance auditing would ensure implementation of labour law, at least for the regulations on hiring and the standards of engagement. One law could be tried as a pilot case. Auditing in registered enterprises under the Factories Act, if given to the private sector, could have a positive outcome.

### ***5.7.6 Lagging performance of labour courts***

Labour courts were established to help deal with matters pertaining to labour issues. Disputes related to labour departments are also decided by these courts. Due to limited resources, considerable time elapses before cases are finally decided. With almost 10,000 cases pending in the labour courts, it is little wonder that entrepreneurs are reluctant to contest cases against government departments.

### ***5.7.7 Streamlining and simplifying***

The daunting number of laws required for compliance could be streamlined. For example, despite the detailed law on factory standards contained in the Factories Act, 1934, another separate law deals with the quality standards laid down for boilers in factories. Called the Boilers Act, 1923, it could be incorporated within the scope of the Factories Act. Here again, private-sector, third-party audits (as recommended in Section 5.7.5) would simplify monitoring.

Similarly, laws related to labour employment standards can also be consolidated and simplified. The Directorate of Labour Welfare of each province implements these laws, which include the following:

- Industrial and Commercial Employment Ordinance 1968
- Payment of Wages Act 1936
- Minimum Wages Ordinance 1961
- Workmen's Compensation Act 1923
- Shops and Establishment Ordinance 1969
- Employment of Children Act 1991
- West Pakistan Maternity Ordinance 1958
- Employment Record of Services Act 1951

The common feature of these separate laws is that they are administered by one department and provide details on conditions of work and hiring practices (standards of engagement) for the labour force including the salary structures, working hours, and maintenance of employment records. For the convenience of entrepreneurs and workers, these could be regrouped under one act containing basic information on these issues.

### **5.7.8 *Laws and impact on employment***

Enterprises with less than 10 workers are exempt from compliance with labour laws, an exemption that acts as a deterrent to switching from the informal to the formal sector. Recently, the government announced a self-assessment scheme procedure to bring into the formal sector those enterprises with 10 or more workers that are still not registered with labour departments. This can only achieve the desired results if the benefits associated with compliance with regulations are propagated effectively nationwide. The commercial aspect and the cost benefit associated with labour levies could serve as a trigger button to facilitate the shift from the informal to the formal sector.

Part 6 of this report tackles the thorny question of access to formal credit sources — a problem for the MSME sector in Pakistan and in all Least Developed Countries.

## **6. Finance and credit policies**

MSMEs are a robust and vital part of the private sector and play an important role in Pakistan's economy. However, they have not met their potential as an engine of growth and production. As is the case with all the Least Developed Countries, the MSME sector in Pakistan has been struggling to access formal credit sources. Limited access to finance has been cited by various researchers as a significant constraint in the operations of SMEs (Aryeetey et al., 1994). Financing is the lifeline of any enterprise — micro, small, medium or large-scale — and each has its specific requirements, depending on initial investment needs, working capital requirements and trade financing.

### **6.1 Finance policy and MSME access to credit**

The State Bank of Pakistan (SBP), the central bank, formulates and implements finance policy and regulates the financial sector. The bank plays a pivotal role in Pakistan's economy, as one of its key functions is to advise the government on monetary and fiscal policy and assist in the implementation of its recommendations. The SBP operates as an autonomous body. Its decisions are based on independent analysis and research of numerous sectors of the economy.

In terms of credit policy, the objectives that drive policy-making encompass employment growth, industrial development, growth of export-oriented industry, commercial viability and enhanced coverage of credit and, most important, measures to restrict wilful default on borrowed money.

The financial sector in Pakistan has passed through numerous phases in its evolution, as the chronology of events in Annex 1 shows. During the early 1970s, the commercial banks and financial institutions were nationalized, leading to a heavy growth in the branch network of banks, intended to generate more employment. The presence of the banks in the public sector also led to "political lending", which resulted in a large number of non-performing loans in the overall portfolio of financial institutions. The process of nationalization also imposed restrictions on banking activities in the private sector. These factors collectively were responsible for the limited availability of finance for the MSME sector, as the focus of financing was diverted to large public sector manufacturing concerns and large private sector enterprises.

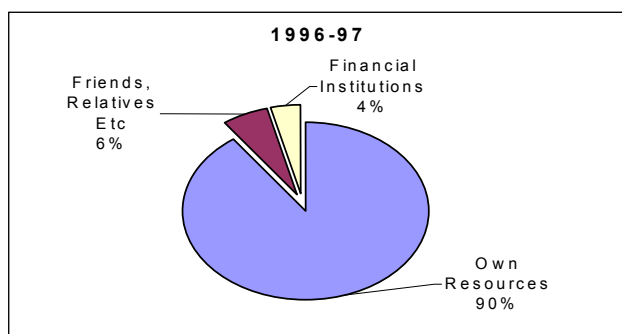
The late 1980s and the early 1990s ushered in an era of banking reforms: the financial sector was liberalized and banking companies were allowed to operate in the private sector. This led to the development of a number of financial institutions which adopted policies to identify new credit markets.

According to the SHMI, almost 17,000 firms in the informal sector obtained credit from financial institutions in 1996-97.<sup>28</sup> However, most MSEs are still unable to access formal credit sources. They finance their business plans through equity or funds obtained from friends and relatives. Figure 6.1 shows that among the unregistered enterprises in the manufacturing sector, almost 90 per cent run equity-financed business plans. The dependence on funds from relatives and formal financial institutions is limited to 6 per cent and 4 per cent respectively.

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<sup>28</sup> The SHMI 1996-97 covers all manufacturing firms that are in the informal sector regardless of their size. Informal sector means the firms which are not registered with the Government departments.

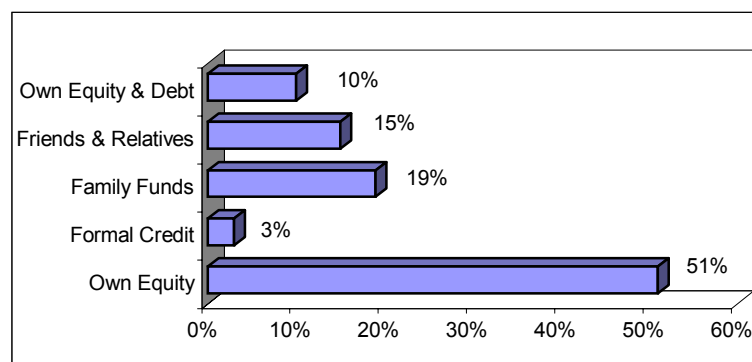
**Figure 6.1: Financing of manufacturing firms in the informal sector**



Source: Survey of Household and Manufacturing Industries, 1996-97.

These tendencies were confirmed by the SMEDA/Gallup MSE Survey, 2001 which covered MSMEs in the manufacturing, trade and services sectors. According to these data, 51 per cent of the sample enterprises had started their businesses using their own funds. Figure 6.2 shows the utilization of credit from formal sources is as low as 3 per cent. However, credit from formal sources increases with the size of the firm. Almost 8 per cent of medium-sized firms have obtained capital from formal financial institutions. Interestingly, the utilization of formal credit was higher than among women entrepreneurs than their male counterparts.

**Figure 6.2: Source of financing at business start-up in MSMEs, 2001**



Source: SMEDA/Gallup MSE Survey, 2001.

The slight chances of success in raising finance from formal credit sources may be one reason why most MSMEs shy away from them. According to the SMEDA/Gallup MSE Survey, 2001 slightly above 20 per cent of the entrepreneurs tried to raise some sort of financing. Family and friends stand out to be the favourite source of short-term financing and the success rate is also the highest (96 per cent) for this source. Commercial banks are considered to be an important source to obtain short-term funds after relatives and friends, but with a lower success rate (66 per cent). Other sources, like the specialized provincial government organizations (the Punjab Small Industrial Corporation; the Sindh Small Industrial Corporation) and Non-Bank Financial Institutions, are rarely accessed. Similarly, in order to meet their long-term capital needs, MSMEs tend to access family and friends as a first choice after equity. Formal credit sources are not regularly accessed. Surprisingly, the MSMEs do not seem to rely on informal money-lenders to meet their long-term capital requirements.

The success rate for medium-sized firms was between 75 per cent to 100 per cent in the case of short- and long-term loans from commercial banks, mainly because a large number of medium-sized firms have formal structures. For micro and small enterprises, the success rate was much lower.

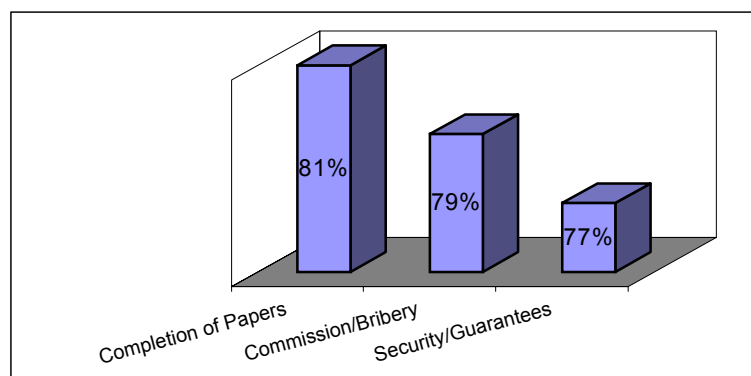
It is very important to determine the factors that influence investment decisions. According to the SMEDA/Gallup MSE Survey, almost 57 per cent of the MSMEs surveyed make investment decisions in response to market demand; 44 per cent cited the premises in which the enterprise operates; and 37 per cent cited their access to financial resources. Among the factors that have a negative impact on investment decisions of MSMEs, government policies were reported by 32 per cent and payment to workers by 30 per cent of respondents. Factors having no impact were: structure of the business (58 per cent), special incentives (57 per cent), government policies (41 per cent) and access to resources and inputs (40 per cent).

Given the importance of access to finance, and despite the fact that government has initiated specialized credit programmes for MSME development (described in Section 6.3), government policies at a broader level seem to have a negative rather than positive influence on investment decisions in MSMEs.

## 6.2 Prudential Regulations and documentation requirements

As discussed above, financing is regulated by the SBP. Its Prudential Regulations stipulate that banks and financial institutions need to secure loans with realizable security. The financial sector has gone one step further; loans are given after obtaining collateral to the value of 120 to 130 per cent of the loan size. One of the foremost problems confronted by the small and medium enterprises in obtaining formal credit is their non-availability of collateral. As Figure 6.3 shows, this observation is confirmed by a recent World Bank-Gallup study of 500 SMEs in Pakistan, in which 77 per cent of small-enterprise investors were discouraged from making investment decisions because of perceived problems with collateral. Recently, the SBP has allowed collateral-free lending up to PKR 100,000, to facilitate micro enterprise development.

**Figure 6.3: Problems faced by MSMEs in securing formal-sector loans**



Source: World Bank, *Pakistan's Small Entrepreneurs World Bank-Gallup Survey, 2001*.

The growth of MSMEs is significantly hindered in Pakistan because there is no mechanism to replace collateral. SMEs in developed countries face similar problems with collateral but the issue is resolved through innovative measures, such as credit guarantee schemes offered by private sector firms and industry associations. In Japan, for example, the



chambers and industry associations provide guarantees on behalf of borrowers to financial institutions. In Canada, France and the United Kingdom, credit guarantee schemes have been introduced, which secure a given proportion of the loan by charging a premium at market interest rates. In Canada, for example, the credit guarantee covers almost 90 per cent of the total amount borrowed by charging a premium of 1.75 per cent on interest rates. Applied on a commercially viable basis, similar measures can assist the MSMEs in Pakistan to enhance their capacity to access formal credit sources.

A second obstacle for MSMEs in Pakistan is the documentation requirements of financial institutions to process loan requests. This issue has three main features: the lack of book-keeping practices in the MSMEs, the structure of these businesses, and the heterogeneity in basic documentation of financial institutions.

Micro enterprises are mainly sole proprietorships,<sup>29</sup> a structure that does not legally require the maintenance of record books of accounts and audits.<sup>30</sup> The Prudential Regulations of the SBP have taken this into account for micro enterprises and the lower end of the small-enterprise sector. Table 6.1 sets out the documentation requirements for the micro-enterprise sector, stipulating that accounts only need to be signed by the entrepreneur/borrower. This provision acknowledges the lack of capacity of micro enterprises to maintain records of financial statements.

For firms which require a maximum of PKR 10 million credit, the accounts need to be audited externally. A range of options is available in the Prudential Regulations to facilitate borrowing. However, this entails extra costs for the small enterprise, as professional assistance is sought from chartered accountants.<sup>31</sup>

**Table 6.1: Documentation requirements according to Prudential Regulations**

<b>Limits on formal lending</b>	<b>Requirement of financial statements</b>
Loan not exceeding PKR 2 million	Accounts duly signed by the borrower
Loan exceeding PKR 2 million but not exceeding PKR 10 million	Accounts duly signed by borrower and countersigned by: The internal auditor of the bank or; A chartered accountant or; A cost and management accountant in case of a borrower other than a public company or a private company

Source: State Bank of Pakistan, 1999.

Finally, bank procedures contribute to making access to credit difficult for MSMEs with limited in-house capacity. For example, the basic loan request form is not standardized within the financial sector. Each financial institution has its own form, the contents of which vary from bank to bank. Standardizing these procedures across the financial sector would enhance the capacity of the MSMEs to complete the forms and comply with procedures without incurring the extra costs of external assistance.

<sup>29</sup> According to the Census of Establishments, 1988 almost 82 per cent are sole proprietorships.

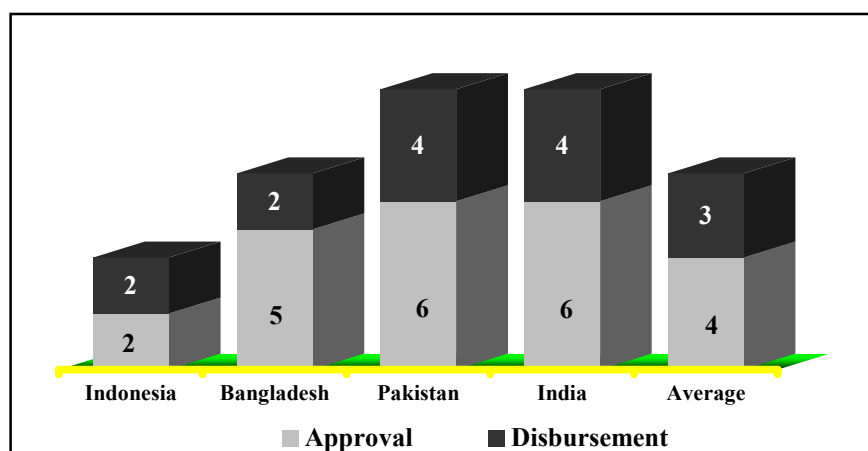
<sup>30</sup> This was confirmed by a small survey of 50 SMEs, where all surveyed firms having less than 10 employees (22.9 per cent of the sample) responded that they did not maintain any kind of formal financial statements (Ali and Sipra, 1998).

<sup>31</sup> An estimated amount of PKR 30,000 is required to obtain a financial statement audit from a recognized chartered accountant or a cost and management accountant.

As stated earlier, a majority of MSME business plans are equity-financed. The Prudential Regulations<sup>32</sup> of the SBP set the debt-equity limit at 60:40 for fresh loans and additional loans required for expansion. This cannot be considered to have any negative effect on the access of MSMEs to formal credit sources. To promote investment in selected sectors, the Prudential Regulations have lowered the debt-equity ratio.<sup>33</sup> This example of good practice could be extended to encompass the MSME sector (after first giving it a standard definition).

Regardless of firm size, the transaction costs charged by financial institutions for the processing and monitoring of loans are similar, since large enterprises are perceived as less risky than smaller ones.

**Figure 6.4: Time involved in loan-processing by financial institutions in selected Asian countries, 1999**



Source: International Trade Centre, *The SME and the Global Marketplace: An Analysis of Competitiveness Constraints* (Geneva, 1999).

Figure 6.4 compares loan-processing time in financial institutions in Pakistan with other selected Asian countries. The average time in Asia is four months for the approval process and another three months for disbursement. In Pakistan, the average time taken for approval and disbursement is ten months, or three months higher than the Asian average.

Considering the size of the enterprises and the relatively small amounts required by MSMEs, processing times could be streamlined. If minimum requirements were introduced for processing MSME loan requests, it would encourage these businesses to seek more financial assistance from the organized sector.

No timeframes are set for loan processing in the Prudential Regulations, which stipulate only the key areas that need to be evaluated in-depth before loan approval and disbursement. It would be an easy step to formulate standardized procedures for the MSME sector in the Prudential Regulations for the purposes of evaluation and assessment, which would also streamline loan-processing time.

Another obstacle to MSME access to formal credit is their lack of awareness of numerous SBP incentive packages and provisions. For example, very few entrepreneurs are

<sup>32</sup> State Bank of Pakistan Prudential Regulation No. 5.

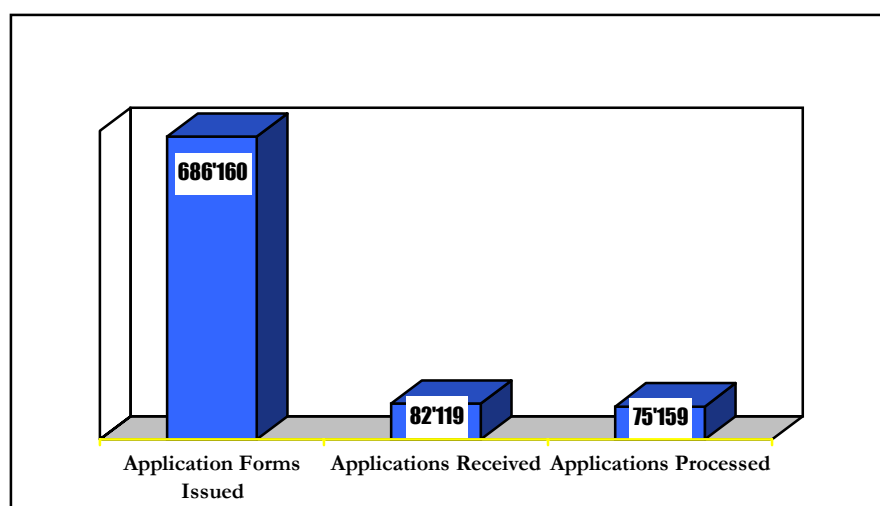
<sup>33</sup> BPRD Circular No. 13, 19 March, 1999: Debt-Equity ratio for transport sector lowered to 70:30.

aware of the Clean Lending Limit,<sup>34</sup> a provision that can facilitate MSEs in borrowing small amounts to meet their short-term capital requirements.<sup>35</sup> The limit is currently too low to cater to the capital needs of a broader band of firms, but if proper awareness is created about this facility, a number of MSEs can benefit from it.

Figure 6.5 demonstrates the effectiveness of awareness-raising campaigns. The Self-employment Scheme was started to provide small loans up to a limit of PKR 500,000 with the objective of creating employment. This scheme was very well marketed through various media to make the general public aware of this credit facility. As a result, almost 700,000 application forms were issued and more than 80,000 applications were received.

Similarly, had there been awareness about the Clean Lending Limit in the MSMEs, a number of enterprises with short-term capital needs would have preferred to access the formal sector rather than paying 40 to 50 per cent premium on prevailing interest rates to money-lenders in the informal sector.

**Figure 6.5: Results of the Self-employment Scheme, 1999**



Source: SMEDA.

The State Bank of Pakistan also regulates the Non-Banking Financial Institutions (NBFIs) in the country, including leasing companies, *modarbas* and *musharikas*. Most of their regulations are similar to those of the commercial banks, with the same effect on financing. The only regulation that could play an important role in MSME development is the limit set by the State Bank for small-business financing. All NBFIs are required to allocate 5 per cent of the total loan portfolio to small enterprises.<sup>36</sup> This can prove to be very useful in extending formal credit to MSEs, if the limits set are observed and properly implemented.

A similar provision for commercial banks could achieve positive results in opening up new vistas of formal sector financing for MSEs. It would also achieve a wider branch

<sup>34</sup> The Clean Lending Limit is an instrument to provide small loans without collateral. The Prudential Regulations of SBP (Regulation No. 3) limit the maximum to PKR 100,000.

<sup>35</sup> Findings of the focus-group discussions conducted by SMEDA.

<sup>36</sup> BPRD Circular No. 22 for NBFIs. Small firms are defined as having a maximum of PKR 20 million investment in fixed assets, excluding land and building.

network for commercial banks,<sup>37</sup> by enhancing reach to far-flung rural areas, and help to familiarize MSEs with the concept of debt as a traditional mode of financing.

### **6.3 Targeted credit schemes**

To address some of the problems of MSME access to the banking system, several targeted credit schemes have been set up by government authorities, banks and NGOs. Some of these initiatives are discussed below.

#### **6.3.1 The Khushali Bank (a micro-credit bank)**

The Khushali Bank has been established recently and its first branch has begun operations in Dera Gazi Khan. Its mandate is to provide a total credit disbursement of up to PKR 60 billion over 5 years to a total of 5.6 million individuals who are not a part of the tax net.<sup>38</sup> In the case of partnerships, the scheme is limited to enterprises earning less than PKR 30,000 a year.

The objective of this particular initiative is to alleviate poverty through providing micro credits. Since it is only in the initial stage, its impact remains to be seen.

#### **6.3.2 First Women's Bank (a micro-credit scheme)**

The First Women's Bank (FWB), established in 1989, has also successfully carried out a micro-credit scheme solely for women entrepreneurs in rural areas. The FWB is the only commercial bank that disburses micro credit to women entrepreneurs. Unlike big commercial banks, the FWB extends advances and loans on a smaller scale (maximum PKR 25,000) and has managed to maintain a 100 per cent recovery rate. The basic aim of the bank is to empower women, especially those from low and middle-income groups.

#### **6.3.3 Financial institutions: The Small Business Finance Corporation and the Regional Development Finance Corporation**

The Small Business Finance Corporation (SBFC) was established in 1972. Since its establishment, it has been used as a platform for disbursing loans at low interest rates. Lending strongly favoured the self-employment scheme, which disbursed micro credits. SBFC has been recently restructured by the government to cater to the needs of a wider range of enterprises. For this reason, SBFC has also redefined its target group by enhancing the upper limit of productive assets to PKR. 100 million for medium-sized firms.

The Regional Development Finance Corporation (RDFC) was established in 1985 with the specific objective of promoting the industrialization of less developed regions. RDFC is a multi-product financial institution. It participates in money market, capital market and micro credit delivery. Besides financing medium to large-sized industrial concerns, RDFC has been involved in disbursing micro and small-sized loans.

#### **6.3.4 Self-employment Scheme**

The Prime Minister's Self-employment Scheme (SES) was launched in June 1998, to provide employment opportunities to jobless or low-income individuals. Initially, it was instigated by the SBFC; later, other banks, such as the National Bank and the Allied Bank also participated. At the time of writing this report, the scheme is almost non-functioning,

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<sup>37</sup> There are more than 50 commercial banks in Pakistan owned by the private and public sector. One public sector bank (Habib Bank Limited) has around 1,700 branches. The total number of leasing companies is 33; these have a very limited branch network, e.g. nowhere near that of one commercial bank.

<sup>38</sup> Incomes of individuals less than PKR 50,000 a year are not taxable.

although it has not been officially abolished. Earlier, SES provided loans with a maximum of PKR 500,000 to eligible applicants. The requirement for obtaining a loan included a personal guarantee or mortgage of non-encumbered property with a value equivalent to the loan amount. The loan carried a 15 per cent mark-up and the repayment period was 7 years with a grace period of 6 months to a year.

As its objective was to create employment across the economy at a rapid pace, the focus of SES was not solely on the manufacturing sector. All the government-owned commercial banks and the specialized DFIs actively participated in the scheme and more than PKR 6 billion worth of loans were disbursed. The actual performance of the scheme based on category of loans and their default rate cannot be evaluated, as no statistics are available. However, based on the disbursement figures and assuming that each loan created one job, an estimated 34,000 new jobs have been generated, as shown in Table 6.2.

**Table 6.2: Disbursement under the Self-employment Scheme, 1998-1999**

	<b>December 5, 1998</b>	<b>October 9, 1999</b>
Amount (PKR million)	1,246	6,497
Number of loans	4,867	34,070
Average loan size	0.256	0.191

*Source: SMEDA, 2001.*

### **6.3.5 Export Finance Schemes**

The first Export Finance Scheme was established in 1972 to provide a credit facility on favourable terms for the export of goods. Finance is divided into two stages: in stage 1, working capital is provided; in stage 2, a finance facility is provided for a loan amount equal to five-twelfths (41.66 per cent) of the total value of exports in the preceding year. The interest rate of only 8 per cent is far below the prevailing market interest rate — a feature of the scheme that makes it a very useful tool for exports development.

In 1998, the scheme was revised to make it available to MSMEs. Now not only MSMEs can benefit from this scheme but also new and indirect<sup>39</sup> exporters who have exported goods up to a maximum of US \$2,500,000 in the preceding fiscal year are eligible. Based on the new modified scheme, the incentive of subsidized credit is also available to the indirect exporter (which acts as a supplier to the exporter). However, the “trickle-down” effect in terms of the small-scale enterprise benefit has not yet been achieved. This policy intervention placed an initiative on direct exporters, requiring them to open an inland Letter of Credit in favour of the local MSME supplier. But the attitude of large-scale business and the low awareness levels among small-scale entrepreneurs result in this initiative being taken up only rarely. Thus, local suppliers and manufacturers who are indirect exporters could also benefit from such incentive schemes. As a matter of policy, the government plans to increase the interest rate and bring it in line with prevailing market rates, reducing its utilization by direct exporters.

### **6.3.6 Pakistan Export Finance Guarantee Agency: Good practice**

The Pakistan Export Finance Guarantee Agency (PEFG) was established with an authorized capital of PKR 610 million. Its objectives include providing a comprehensive range of export trade finance guarantees to exporters, indirect exporters (a majority being MSMEs) and other growth sectors. PEFG issues bankable guarantees on behalf of new and small exporters, in favour of partner banks who will provide trade finance facilities from

<sup>39</sup> The term “indirect exporter” refers to an enterprise that acts as a sub-contractor for an exporter.

US \$100,000 up to the maximum limit of US \$2.5 million a year. It also provides up to 80 per cent repayment guarantee, up to US \$100,000 (in Pakistan rupee equivalent at prevailing exchange rate) per transaction. The guarantee can be substituted for traditional collateral and is accepted as such by participating banks. This guarantee is targeted primarily to the MSMEs and to more established but emerging exporters wishing either to enter new markets or introduce new products.

PEFG can be considered as good practice since it replaces traditional collateral requirements with a competitively priced PEF certificate, which is used as a guarantee by financial institutions when considering pre-shipment export loans. This is of real benefit to MSMEs in the export business. However, firms operating solely in the domestic market cannot access any credit source without collateral.

#### **6.4 Summing up**

Traditionally, the MSME sector in Pakistan has depended on equity financing not debt financing to meet short- and long-term capital and trade credit requirements. Various factors have contributed to this position: lack of awareness of the government regulations under which financial institutions operate; the informal nature of business; a lack of collateral; interest payments; and the lack of capacity to comply with auditing or documentation requirements.

At the policy level, consistent government efforts have been made to enhance the access of the MSMEs to formal credit sources. Realizing that most of these enterprises operate as proprietorships, the Prudential Regulations waiver small firms from documentation requirements.<sup>40</sup> Similarly, the State Bank of Pakistan has also allowed collateral-free lending up to PKR 100,000 to facilitate micro enterprise development.

To meet the credit needs of micro enterprises, the government has also established the Khushali Bank, providing small loans of up to PKR 30,000. Similarly, specialized financial institutions, such as the First Women's Bank, cater to the credit needs of women entrepreneurs. Recently, the Government announced the establishment of an SME Bank<sup>41</sup> proactively engaged in extending credit to the MSME sector.

As far as trade financing is concerned, the State Bank of Pakistan offers export finance at subsidized rates. This scheme has been modified to take into account the need of small and medium-sized indirect exporters. Similarly, the Export Finance Guarantee scheme has been initiated to facilitate the small and medium-sized exporters by replacing traditional collateral with guarantee.

Notwithstanding these efforts, the MSMEs still do not consider formal credit sources as their main source of funding, because collateral requirements are a major deterrent. The foremost issue is the absence of cash flow based lending in the financial system of Pakistan. Other impediments include the lack of awareness<sup>42</sup> among MSMEs on the programmes and incentive packages of various financial institutions, non-standardized credit application and

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<sup>40</sup> Where the Bank's risk does not exceed PKR 2 million, the banks accept accounts duly signed by the borrower. The borrower is not required to have audited books of accounts.

<sup>41</sup> SME Bank will be established after the merger of the Small Business Finance Corporation and the Regional Development Finance Corporation (RDFC).

<sup>42</sup> Almost 60 per cent of respondents in Gallup/BRB Survey had a bank account; 84 per cent of entrepreneurs in rural areas had no bank account.

loan evaluation procedures, and a lack of understanding about different financial tools, such as leasing.

Formal sector financing avenues are being introduced into finance policy in an attempt to widen the tax net in Pakistan. Part 7 examines the reasons why many MSMEs prefer to remain in the undocumented informal sector.

## 7. Taxation policy

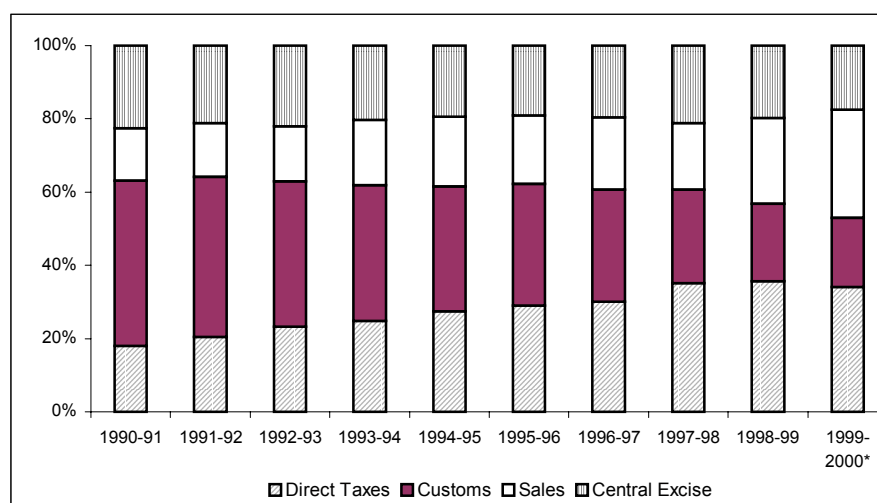
### 7.1 Overview of the taxation system

At present, there is no specific taxation policy within Pakistan's policy framework. Taxation reforms are made through tax measures announced annually in the fiscal budget. In the past decade, Pakistan has seen a shift from indirect to direct taxation. While the tax base for most of the taxes has grown faster than GDP in Pakistan, tax rates have been reduced, so that tax revenues are stagnant when measured as a share of GDP.

The primary aim of government tax measures is to increase the tax-to-GDP ratio. The government previously increased revenue by increasing the tax rates for existing taxpayers. The recent national shift in tax policy is to broaden the tax base and bring about a more equitable system of taxation.

Figure 7.1 illustrates the shift in the tax policy during the 1990s from direct to indirect taxation. The share of direct taxes in total tax revenue has almost doubled, from 18 per cent to 34 per cent, while the share of indirect taxes declined from 82 per cent to 66 per cent. Within the indirect taxes, the share of import-based taxes declined and the reliance on consumption-based taxes increased. This change is due to a reduction in import tariffs.

**Figure 7.1: Tax revenue collected (total tax revenue=100), 1990-2000**



\*Figures for 1999-2000 are estimates.

Source: Ministry of Finance.

In 2000, the total number of income-tax payers was around one million and sales-tax payers numbered 62,000. Total taxpayers in Pakistan are 0.8 per cent of the total population — one of the lowest rates in the world. The number of unregistered manufacturing concerns paying indirect taxes including sales tax, excise duty, customs duty and various other taxes was 427,784 in 1997.<sup>43</sup> As part of government efforts to increase the tax base, a documentation campaign has also been initiated. This will help in documenting the informal sector enterprises and, ultimately, encompass them in the tax net.

<sup>43</sup> The information is collected from the Small Household and Manufacturing Industries Survey, 1996-97.



The Ministry of Finance is responsible for the formulation of annual fiscal policy, incorporating inputs and recommendations from other ministries into the final product. Public-sector development institutions, the Federation of Chambers of Commerce and Industries and other private sector organizations are also consulted.

The Central Board of Revenue (CBR) is the main institution for the collection of taxes at the federal level, and through its various departments on a provincial basis. In practice, the targets set for tax collection in Pakistan are so high that on many occasions the government falls short. The main reason for these high targets is the pressure to meet deficit payments and expenditure.

Since the mid-1990s, the legal and administrative structure of Pakistan's tax system has undergone frequent ad hoc changes that have not been followed up with appropriate changes in administrative departments. The result is that taxpayers are not fully aware of their tax obligations and tax collectors have substantial discretionary power. Taxpayer and tax collector each perceive the other as lacking in integrity. Adding to the friction, the administration's facilities, systems, human resource skills and budget expenditure have not increased according to needs.

## **7.2 Sector-specific taxation policy measures**

The structure of taxation policy is invariably sector-specific, but in the present situation tax measures cannot be announced on the basis of enterprise size, or translated into size-specific objectives, due to the lack of a standard definition for MSME establishments — a lack that is emphasized throughout this report. Both the Ministry of Finance and its implementing agencies do not recognize the micro, small and medium sector. The varying definitions within each institution create confusion, particularly in regard to tax incentives. Attempts are now being made by the government to offer tax incentives to the micro and informal sector so that they may enter the tax net. Some of these incentives are discussed in Section 7.3.1 on income tax.

Consequently, taxes are imposed on specific sectors where the assessment criteria are easier. For this reason, fully documenting the economy is urgently needed. This will increase the statistical data currently available and allow sizes of industries and sectors to be defined more comprehensively and coherently.

## **7.3 Tax legislation**

The main taxes imposed and collected at federal level include taxes on income (other than agricultural), on capital value of assets, customs duties on international trade, excise duties, and taxes on the sale and purchase of goods produced, exported, imported, manufactured or consumed. The administration of Pakistan's tax systems such as income tax, sales tax, central excise and customs is within the CBR and its subordinate departments.

The CBR collects tax revenue thorough various federal and provincial taxes. Apart from the federal taxes collected (via provincial collectorates) within each province, there are additional taxes based on infrastructure requirements, specific sectors and types of human resource. Table 7.1 illustrates federal and provincial taxes, taking the Province of Punjab as an example. Certain sector-specific provincial taxes have been included, to demonstrate the high number of taxes imposed on enterprises.

**Table 7.1: Taxes imposed on enterprises in Pakistan, 2001-02**

<b>Taxation</b>	<b>Federal Level</b>	<b>Provincial Level (Punjab)</b>
Direct Taxation	Income Tax Wealth Tax	Property Tax
Indirect Taxation	Sales Tax Central Excise Tax Customs Tax	Punjab Sales Tax Punjab Excise Tax Entertainment Tax Cotton Fee Professional Tax Hotel Tax Registration Fee Corporation Taxes Capital Value Tax Local Council Fee (for rural areas)

Source: SMEDA.

The impact of these different taxes is twofold. First, each type of tax forces the enterprise into interaction with the relevant government agency — a source of considerable costs in time that bear on the productivity of the MSME entrepreneur. Second is the financial drain of the numerous taxes imposed. When entering the formal net, smaller sized firms conduct a cost-benefit analysis to determine the benefits of such a move. Given the number of taxes and the level of interaction with government agencies (often perceived as having associated “corruption costs”), many MSMEs prefer to remain in the undocumented informal sector.

### **7.3.1 Income tax**

The Income Tax Ordinance, 1979 stipulates how income tax is calculated; the powers given to enforcing establishments and their employees; penalties imposed in the case of non-compliance; and the steps for compliance. Income tax is levied on the income of persons, sole proprietorships, partnerships and companies operating in Pakistan. When income tax measures are announced in the fiscal policy, these are implemented in the shape of a statutory regulatory ordinance or SRO.

Income tax in Pakistan is based on the progressive taxation system used in many countries across the globe, which relies on the principle of “the greater earnings the higher the tax bracket.” The tax rates also vary depending on the type of incorporation and on the fiscal status of the enterprise or taxpayer. For the purpose of this report, income taxes on salaried workers have been excluded.

**Table 7.2: Income tax rates, according to type of business structure, 2001-02**

Total Income	Rates of Income Tax
<b>Sole proprietorship</b>	
Up to PKR 60,000	Nil
PKR 60,001 to 150,000	7.5% of the amount exceeding PKR 60,000
PKR 150,001 to 300,000	PKR 6,750 + 12.5% of the amount exceeding PKR 150,000
PKR 300,001 to 400,000	PKR 25,500 + 20% of the amount exceeding PKR 300,000
PKR 400,001 to 700,000	PKR 45,500 + 25% of the amount exceeding PKR 400,000
Exceeding PKR 700,000	PKR 120,500 + 35% of the amount exceeding PKR 700,000
<b>Registered partnerships</b>	
Up to PKR 30,000	Nil
PKR 30,001 to 80,000	5% of the amount exceeding PKR 30,000
PKR 80,001 to 130,000	PKR 2,500 + 10% of the amount exceeding PKR 80,000
PKR 130,000 to 180,000	PKR 7,500 + 15% of the amount exceeding PKR 130,000
Exceeding PKR 180,000	PKR 15,000 + 25% of the amount exceeding PKR 180,000
<b>Companies</b>	
Banking Company	50%
Public Company other than banking company	35%
Other companies	45%

Source: SMEDA.

Table 7.2 illustrates that in contrast to tax rates for private and public companies, both sole proprietorships and registered partnerships are calculated progressively, according to an ascending scale of income brackets. As most MSMEs are sole proprietorships and partnerships, the temptation is to under-report profits in order to avoid falling into the higher income bracket.

Recently, the government reduced the number of tax brackets from seven to five and exempted sole proprietors earning income less than PKR 60,000 (previously PKR 40,000) from payment of income tax. This has had a positive effect on the growth rate of MSEs, as the majority operate within these brackets. The lower tax rates for enterprises with low incomes may encourage micro enterprises to enter into the income tax net.

Sole proprietors and unregistered firms benefit more from the current lower tax rates than do registered firms. For example, an enterprise earning PKR 180,000 has to pay PKR 10,500 in income tax as a sole proprietor, but PKR 15,000 as a registered firm.

The self-assessment scheme can be a good means of reducing the cost of compliance time-wise, by allowing MSEs to file tax returns without any interaction with the tax collector. Such a scheme can be considered good practice and is already available to a number of MSEs in Pakistan.

In 1997, the number of tax filers under the self-assessment scheme was 359,000 or 34 per cent of the total tax filers. Among the participants in the self-assessment scheme, more than 90 per cent were MSMEs.<sup>44,45</sup>

Enterprises in the scheme are required to attach various documents with the tax returns, including manufacturing/trading accounts, profit and loss accounts and balance sheet statements. If accounts have not been maintained, enterprises must attach estimates and documents to support these estimates.

Under the tax law, among all returns filed, 20 per cent returns may be selected for total audits. This auditing procedure also includes enterprises using the self-assessment scheme.

The main limitation of the self-assessment scheme is a considerable bias: for companies to participate in the scheme, their declared income is required to be 10 per cent higher than their performance in the previous year. For sole proprietorships and partnerships, it is set at 20 per cent higher, an unrealistic growth rate for many enterprises and a reason for the scheme's low utilization.

All enterprises regardless of their size or nature of business are required to submit annual tax returns at the end of each fiscal year (June 30). Maintaining records and accounts is a prerequisite to calculating tax liability — an obstacle for micro-sized enterprises with limited resources, unable to hire accounting professionals. Annex 4.1 explains the procedures required for the filing of an income tax return. As the size class of the enterprise increases, the problem diminishes due to the presence of accounting professionals.

### **7.3.2 Sales tax**

Sales tax is imposed on the sale, importation, production, manufacture or consumption of goods.<sup>46</sup> The tax base for sales tax has increased considerably over the past 10 years, the government imposing it on various stages of an enterprise's activity. In the earlier stages of implementation, the scope of the sales tax was restricted to manufacturing and import but has recently been extended to include wholesales and retailers.

Various types of sales tax are applied in different countries (VAT in Europe, GST in North and South America), with a general global shift away from import-based taxation to consumer goods. This best practice is now being implemented in Pakistan with considerable pressure.

The sales tax payer must ensure that sales tax is paid on goods received and deducted on goods sold. The difference between these two amounts is the final sales tax liability and may be verified by the sales tax collectorates — either by request or random spot checks. Companies with their own financial accounting departments do not experience the paperwork difficulties that MSMEs have in maintaining records of purchases, sales and the monthly

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<sup>44</sup> Tax filers under Self-assessment scheme = 359,000

Number of companies benefiting from self-assessment = 4,000 (Number of companies registered as taxpayers = 22,000 — Number of companies filing taxes in other category = 18,000)

No. of registered firms = 7,000

No. of MSMEs in Self-Assessment = 359,000 - 4,000 - 7,000 = 348,000

Percentage of MSMEs in Self-assessment scheme = 348,000/359,000 = 97 per cent

<sup>45</sup> Lahore University of Management Sciences Report on restructuring of CBR.

<sup>46</sup> Although the sales tax is also applied to exports, exporting firms are entitled to a full refund of sales tax paid on exports (see 7.3.3).

calculation of sales tax liabilities. Calculating the sales tax liabilities due is a complex procedure, with different rates applicable to different goods and services. Moreover, the random audits create unnecessary problems in daily business routine.

The general tax rate applied on certain categories of goods imported and produced locally is 15 per cent. In the case of 200 industrial raw materials, a higher tax rate of 20 per cent applies. In case supplies are made to an unregistered person or enterprise, a further tax of 3 per cent will be added to the sales tax of 15 per cent or 20 per cent.<sup>47</sup>

Since a large proportion of MSMEs are unregistered firms and sole proprietorships, the imposition of an additional sales tax of 3 per cent may have a negative impact on sales. Although partly refundable, the refunding procedures are not efficient and can lock funds for a considerable time. Unregistered enterprises are under pressure to become registered. At this point the MSMEs face a dilemma: income tax rates for sole proprietors and unregistered enterprises is lower than for registered firms. On the other hand, sales tax for the registered firms is lower. Thus, MSMEs must evaluate which option is more advantageous.

As an alternative to sales tax and the paperwork it entails for small enterprises, the government has introduced a simpler form of tax on consumer goods. Called the turnover tax, it is computed at the uniform rate of 2 per cent on enterprise turnover. Annex 4.2 shows the method of computation used for sales and turnover tax and the submission of return forms. Providing the producer or manufacturer does not exceed PKR 2.5 million and a retailer PKR 5 million in turnover, they are entitled to pay turnover tax. This will be based on records kept by the entrepreneur which may be checked by random inspection of the Sales Tax Department and its collectorates. A large proportion of the SMEs fall under the umbrella of turnover tax and could take advantage of the 2 per cent rate. The drawback here again is that of paperwork for MSEs: enterprises paying turnover tax in lieu of sales tax are required to submit sales tax returns at the end of each quarter. The main reason most SMEs are not taking this tax opportunity is lack of awareness about this incentive scheme.

### **7.3.3 Sales tax refunds: Long delays cause cash flow problems in MSMEs**

Sales tax is refundable in the case of imports of goods for the purpose of exporting, unregistered transactions, etc. However, the current infrastructure is not providing these refunds in a reasonable timeframe — a source of financial constraint for any enterprise, especially the MSME sector, where the result is reduced production or supply of goods until the finances are released.

It also precipitates intensive interaction with tax officials, compromising the principle of self-assessment. Verification of invoices/shipping bills, etc. and the long manual process create cash flow problems. On average, the refund claims take longer than the legal time limit of 40 days. During the period refunds are tied up, the MSMEs bear a cash flow cost, as they have to access other sources of cash. If the money required for day-to-day running is withheld by the tax authorities, it can lower the SME exporter's productivity and also reduce confidence in the timely delivery of exportable goods due to shortage of funds. The SME sector in Pakistan has low levels of education and management skills and is generally unable to maximize financial resources. This is a major hurdle for small and medium exporters and their subsequent growth.

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<sup>47</sup> This additional tax for sales to unregistered enterprises was recently doubled from 1.5 per cent to 3 per cent.

Despite these obstacles, the SMEs contribute considerably to Pakistan's total exports, thus showing their immense potential. To illustrate the discrimination against indirect or new exporters, a summary of the SRO distributed to exporters, importing and paying sales tax for the sole purpose of exports, is set out below.

The Sales Tax Refund Rules under the SRO 417(1) 2000 relate to Sale Tax refunds given to exporters on the basis of the following criteria:

- ⇒ Gold Category: Businesses that have certified books with 6 months audited accounts of the Sales tax department showing 90 per cent acceptance level of refund claim. Refund to be received within 9 working days.
- ⇒ Silver Category: Businesses that have 90 per cent acceptance as mentioned above, and also have bank certificate from loan limit indicating credit limit of 4 times the amount of refund claim. Refund to be received within 15 days.
- ⇒ All other types of businesses that do not fulfil these criteria fall into the category of "others" and are refunded their claims within 30 days.

Annex 4.3 shows the different stages required for a sales tax refund. A large number of SMEs that are categorized as indirect exporters<sup>48</sup> may not access this "fast-track" facility and are still contributing significantly with regard to sales tax. And although this time period is legally defined, it is still not achieved in practice. A conscious effort by the government to resolve this issue has resulted in considerable improvement in refunds pending between 1997-2000.<sup>49</sup> In 1997, 60 per cent of all refund claims were pending for more than 90 days. However this dramatically changed to only 15 per cent in July-November 2000, with 57 per cent of refunds being released within 30 days. However, there is still a lot of room for improvement as the protracted delays in refunds have a detrimental effect on the MSME sector.

## **7.4 Implementation of taxation policies**

### **7.4.1 Tax administration: Complexity, hierarchy, red tapeism**

As noted early, the CBR has appointed tax collectorates at the provincial level. Collectorates for income tax, sales tax, excise and customs are separate and each has more than nine fields in which they operate. The structure<sup>50</sup> of various tax departments is exceedingly complex. For example, in the sales tax department the hierarchy of authority levels begins with a member of sales tax, followed by chiefs, then joint directors, the executive collector and the adjudication collector. Annex 4.4 charts the functions and timeframe required for adjudication under the Sales Tax Act, 1990. The sales tax department is composed of six divisions: registration, assessment and processing, refund, audit, enforcement and computerization. The registration division is split into de-registration, registration and compulsory registration departments, while the enforcement division has recovery, survey and other functions departments. The results of the complexities of departmental structure are endemic bureaucracy, red tapeism, and a business community spending considerable amounts of time and resources in dealing with tax issues. For MSMEs in particular, with low awareness and understanding of the tax system, this complicated structure only adds to the confusion of the sector. Interaction with tax officials takes place on

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<sup>48</sup> Indirect exporters are those that produce for the purpose of export but do not export themselves.

<sup>49</sup> Source: Study on Business Process Reengineering of the Sales Tax System in Pakistan, April 12, 2001.

<sup>50</sup> Source: Reform of Tax Administration in Pakistan, April 14, 2001.

successive levels of the departmental structure and at each different stage the MSME entrepreneur is confronted with different multiple form-filling. Unfamiliarity with paperwork, a lack of the requisite human resource management skills, and the time lost in productivity are barriers to the entry of the MSME sector into the tax net.

The concept of the taxpayer as client is unknown to the taxation officials in Pakistan: many interactions between taxpayers and the income tax department, be it assessment, obtaining refunds or exemption certificates, are fraught with unnecessary hurdles and delays that border upon harassment.

#### **7.4.2 *Perceived corruption and speed money***

The CBR is perceived as an infrastructural and administrative mammoth: it has approximately 33,000 employees and, under current regulation, extremely wide discretionary powers. It is generally considered prone to high levels of corruption. In its fundamental role of collection, the tax administration is relatively weak — one of the reasons the tax to GDP ratio has not increased. A recent study estimated revenue losses in the three main departments as 64 per cent in the income tax department, 48 per cent in customs and 45 per cent in the sales tax department.<sup>51</sup>

Respondents in a recent public opinion survey rated the perceived corruption level in the income tax department at 3.17 and in the sales tax department at 2.75, on a scale of 1-5.<sup>52</sup>

Overnight changes in the tax structures, accomplished by issuing SROs, have had a major negative impact on the MSME entrepreneurs. Most are not aware of the extent of the changes, leaving room for administrative manipulation of taxpayers at some cost. Proper guidance in how to deal with the changes is not available. In addition, MSMEs face the possibility of extortion during the assessments of their accounts. The MSME entrepreneurs are not sufficiently educated or familiarized with the tax system; tax collectors, aware of this weak point, may exploit them. On the sales tax front, tax collectors have greater chances of extortion: aware that exporters must meet deadlines, they may delay the assessment of imported items. Speed money is the most common form of corruption. The speed money payments for a sales tax refund are given in Table 7.3. The practice is highly institutionalized at each step in the sales tax refund department.

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<sup>51</sup> Source: Study on Corruption for the Task Force on Reform of Tax Administration, April 13, 2001.

<sup>52</sup> Source: Study on Corruption for the Task Force on Reforms of Tax Administration, April 13, 2001.

**Table 7.3: Speed money payments for sales tax refund, 2001**

<b>Paid to</b>	<b>Amount paid (PKR)</b>
Auditor/S. Auditor	6,000
Dispatcher	300
Computer	100
AC Sepoy	300
Auditor/S. Auditor Sepoy	200
Verification Letter	100
<b>Total</b>	<b>7,000</b>
If the refund cheque is needed by hand for an urgent reason:	
Account Officer	3,000
Sepoy	200
<b>Total</b>	<b>3,200</b>
<b>Total</b>	<b>10,200</b>

Source: Source: Government of Pakistan, Task Force on Reforms of Tax Administration: Study on Corruption, July 2001.

In order to obtain a refund urgently, the MSMEs bear the cost of PKR 10,200 — a good reason for their reluctance to avoid entering the tax net. The other form of speed money expenses is as a percentage of the refund amount. This percentage ranges between 0.5 to 2 per cent, depending upon the amount of refund. The rates of speed money are inversely proportionate, i.e. the smaller the amount of refund, the higher the rate of speed money.

### **7.4.3 E-Government Project**

Although this project is not targeted to MSMEs, it should be mentioned here in the context of government response to public opinion. In an attempt to cut red tapeism, the aim of the E-Government Project is, initially, to develop web pages of all government departments that are involved in public dealing. This step has been taken to create broader awareness through connectivity to the Internet; later phases will provide online solutions to the public in dealing with government departments and to reduce interaction. The CBR now has a website providing online information and from 2001 onwards tax return forms could be accessed and completed online by computer-literate taxpayers. Such measures, if implemented across-the-board, can significantly improve the regulatory environment by introducing transparency and reducing interface with government officials.

To gain an understanding of the scope and level of interaction between MSME entrepreneurs and the tax authorities, Gallup considered the registration process.

### **7.5 Registration with tax departments**

For the purposes of this report, Gallup conducted a survey on MSME interaction with tax departments. Table 7.4 illustrates the share of registered units in various types of enterprise. The scope of the tax authorities varies in relation to geographical location. The share of registered units is 70 per cent in urban areas, compared to 40 per cent in rural areas. This is indicative of the limited scope of the tax administration and its difficulty in encompassing the rural sector into the tax net. This is one reason why Pakistan has one of the lowest tax bases in the world.



**Table 7.4: Scope and interaction with tax departments in MSMEs according to geographical location, 2001**

Registration

Agency		Gender		Location		Size		
		Male	Female	Urban	Rural	Micro	Small	Medium
Total Cases	333	285	48	201	132	167	127	39
MSMEs registered with the following agencies (%)								
Income Tax	58	61	38	70	40	44	68	85
Sales Tax	44	49	15	49	37	31	54	72
Excise Tax	20	22	2	28	6	8	27	46

Source: SMEDA/Gallup MSE Survey, 2001.

Tax official visit

Tax official visit	Total	Location		Size			Sector of Business		
		Urban	Rural	Micro	Small	Medium	Trade	Services	Manufacturing
Cases	333	201	132	167	127	39	102	124	107
Income Tax Department	37	33	45	39	38	24	42	37	33
Sales Tax Department	33	35	29	39	26	38	24	31	42
Central Board Revenue	10	14	2	0	18	14	8	15	7
Army Survey Teams	8	8	10	12	5	10	18	4	5

Source: SMEDA/Gallup MSE Survey, 2001.

The number of registered units and visits increases with enterprise size. The larger the number of workers employed, the greater the interaction with government, both in registration and visits. Another interesting point is the aspect of gender division. Only 15 per cent of women entrepreneurs have registered with sales tax authorities, compared to 59 per cent of men entrepreneurs. This may indicate a greater unfamiliarity or lack of awareness of taxation among women entrepreneurs.

The SMEDA/Gallup MSE Survey also evaluated the decision-making process of MSME owners with regard to employment, investment and registration. Respondents (63 per cent) were positively influenced by the availability of insurance and official protection offered when registering for income tax; 42 per cent of respondents were negatively influenced by fines and harassment associated with income tax registration. When deciding to increase or reduce the level of employment within their enterprise, the priority given to tax issues was relatively low.

## 7.6 Observations on the taxation system

### 7.6.1 Taxation policies

Taxation policies in Pakistan are based on short-term measures. When the annual federal budget is announced, numerous amendments in the taxation system form an integral part of budget provisions. The fragmented nature of MSEs and their informal-sector location

makes it difficult for the government to tailor measures specific to all MSME requirements. The solution is to classify enterprises according to the nature of their activities and their size.

At present, tax departments differentiate among enterprises on the basis of annual turnover. Labour laws define enterprises on their number of workers. It would be useful if the definition of MSMEs was uniform and standardized for all regulatory purposes, taxation or otherwise.

### **7.6.2 *Understanding tax policies and procedures: Language and literacy***

Given the low literacy level, the tax procedures and documentation requirements cannot be considered as easy to comply with for a typical micro enterprise. In fact, those micro enterprises that operate in the formal sector, as well as many small and medium-sized enterprises, tend to rely on the help of a lawyer with expertise in tax matters.

The recently launched CBR web page would benefit from a simplified and user-friendly information package in English and in Urdu, to enhance the understanding of the general public on tax matters.

### **7.6.3 *Cost of compliance***

The compliance issue centres on the collection mechanism of the tax authorities and how it empowers them to scrutinize the accounts of enterprises as and when desired. Micro and small businesses not operating as companies have a lack of qualified accounting systems and a lack of understanding of the regulatory framework. This increases their difficulties in dealing with government officials and leaves them more open to harassment. In turn, it is the inability of the micro and small enterprises to meet the standard requirements of the law that increases their vulnerability.

### **7.6.4 *Tax culture, transparency and government performance***

Developed countries have higher tax rates as well as a high number of tax payers because they have a tax culture that is based on transparency in government expenditures and the benefits offered through public welfare programmes and infrastructure development. The lack of a tax culture in Pakistan, where the ratio of direct taxes to GDP is as low as 4 per cent, is reflected in government performance. The high level of non-development expenditures and lack of transparency in government spending is similarly reflected in the population's unwillingness or inability to contribute to the national exchequer.

### **7.6.5 *Government efforts to document the national economy***

In an effort to broaden the tax net and bring the undocumented economy into the formal sector, the government has launched a major documentation campaign for tax purposes in 13 major cities. This tax survey is being conducted under the "Survey for Documentation of the Economy Ordinance 2000". Initially, it targets urban areas where the business community is comparatively familiar with the regulatory framework (compared with rural areas). The unfamiliarity of the micro and small enterprises operating in the informal sector and their negative perceptions of the discretionary powers given to the officials involved in the survey process remains a problem. These officials have power to arrest individuals they consider to be withholding the information requested.

Another weakness in the process is that before initiating the survey, no educational or awareness campaign for the business community was conducted. Had the tax departments done so, it would have enhanced understanding on the tax regulations. The tax authorities

focused only on meeting their targets, ignoring the need to improve the perceptions of and relationship between taxpayer and tax collector.

#### ***7.6.6 Delays in processing***

A salient feature of numerous tax departments is the prolonged delays in processing refunds. Section 6.3.4 describes a case in point, where sales tax authorities, for their convenience, discriminated on the basis of enterprise size. The “Gold” category of companies registered under the Companies’ Ordinance, with audited accounts, has the highest chances of getting refunds processed. The “Silver” category, although it does not require an enterprise to be registered as a company, does require them to submit a bank certificate indicating a loan limit four times the total amount of the refund claimed. The micro and small enterprise category cannot benefit from government incentive systems and wait extended periods to get their refunds processed. Even then, certain fixed rates (speed money) over and above the actual costs have to be paid. For the micro and small enterprises, already financially starved, such bottlenecks and refund delays place undue pressure on their cash flows.

The lack of recognition of the MSME sector and the lack of a standard definition in taxation policy described in Part 7 resurfaces in trade policy — a recurring theme that Part 8 discusses in regard to the lack of MSME-specific measures in policy formulation.

## 8. Trade policy

Trade policy in Pakistan aims at maximizing the gains from international trade and encouraging an efficient and competitive domestic market. Export promotion and import substitution are the two key elements, with the current emphasis on developing industries that can sustain competitive advantage. Incentives are provided to enable these industries and sectors to meet the challenges of globalization. The Ministry of Commerce determines the direction of Pakistan's economy through the analyses of trade regulations. Trade policy is formulated each year and short-term measures are adopted. Formulation is an interactive exercise, incorporating various incentives and sector development strategies from other government departments and representative institutions, as well as defining the numerous procedures relating to imports and exports.

### 8.1 Policy formulation: A lack of MSME-specific measures

As noted already in Section 7.2.1 in regard to tax policy, the same lack of recognition of the MSMEs is evident in the trade policy framework. The focus for strategy is on the economic sector (agriculture, manufacturing and services) and not on enterprise size.

To date, no MSME-specific plans have been formulated and the MSME sector is not represented. Input is obtained from key industry and trade associations in the country (currently over 140 organizations). To ensure regional coverage during the policy-making process, the Chamber of Commerce and Industries, which are dominated by large-scale industries and trades, take the leading role. The industry associations, which represent specific sectors, are left out of the policy-making process. Moreover, mainly for political reasons, there is no structured framework to regulate industry associations, so that several different industry associations exist — even in one sector. This further dilutes the representation of MSMEs in trade policy formulation, in favour of the large-scale firms and the organized sector.

**Table 8.1: MSME registration with industry and trade associations (percentage), 2001**

	TOTAL	Sector of business			Size of business		
		Trade	Services	Manufacturing	Micro	Small	Medium
Registration with Chamber of Commerce (%)							
Yes	20	10	10	40	7	28	49
No	76	88	85	55	90	68	44
Registration with Industry Association (%)							
Yes	27	15	29	36	10	39	59
No	71	83	69	62	87	60	38

*Note: Percentages do not add up to 100 due to non-responses.*

*Source: SMEDA/Gallup MSE Survey, 2001.*

As Table 8.1 shows, only 20 per cent of MSMEs surveyed are registered with the Chamber of Commerce. A slightly higher number, 27 per cent, are registered with an industry or trade association. Representation of enterprises in these organizations increases with enterprise size. Thus, large firms are able to safeguard their interests at a national level whereas MSMEs are neglected in vital decisions at the policy level. However, size is not the only reason that restricts an enterprise from membership in industry and trade associations. In general, MSME entrepreneurs lack awareness of the role of industry associations and do not recognize the use they can make of this platform to voice their concerns.

## 8.2 Importance of trade for the MSME sector

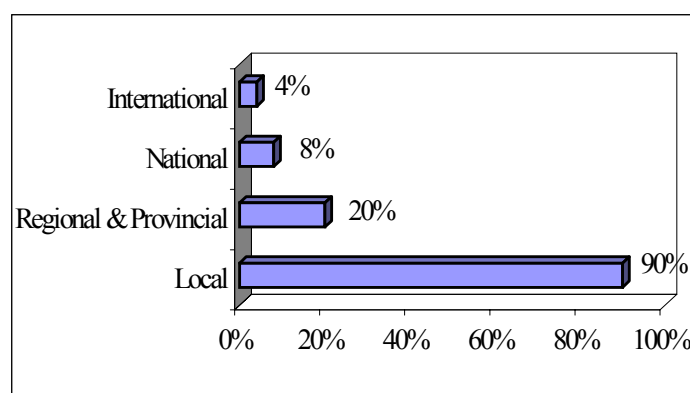
The survival of MSMEs in Pakistan largely depends on trade. As manufacturers of finished products, the MSMEs import various industrial inputs; as exporters they contribute significantly towards total national exports. It is impossible to estimate the exact share of MSMEs in total exports because no data are reported.

A large majority of enterprises in the informal sector contribute indirectly to total export earnings, with process vendors operating in almost all the industrial sectors. The textile industry contributes almost 60 per cent to national total exports, of which 25 per cent are fabric exports. Fabric manufacturing in Pakistan is concentrated in the un-organized “Power Loom” sector. Located in Faisalabad, its small manufacturing units account for more than 60 per cent of the total fabric production in Pakistan. Although it is the country’s major producer of fabric, the Power Loom sector is not a direct exporter, but it serves the needs of commercial exporters and suppliers to international markets.

Similar examples abound: surgical instrument manufacturing and the sports goods manufacturing and apparel industry (all with large numbers of small vendors) operate as suppliers or indirect exporters. There is also a large presence of direct small and medium-sized exporters in these sectors, so a conservative estimate for the total exports contribution of MSMEs lies within the range of 30 to 35 per cent.

Figure 8.1 gives the major markets for MSME products and services in 2001. The SMEDA/Gallup MSE Survey also revealed that the operations of the majority of MSME enterprises are highly localized, due to their limited resources to carry out marketing and distribution. They tend to concentrate locally; the regional and national level markets are not their main source of earnings and their presence in the international markets<sup>53</sup> is limited. This does not imply that the enterprises surveyed do not play an active role in exports; they operate mainly as sub-contractors for direct exporters. The Survey also found that one category of small and medium enterprises exists for which foreign countries constitute core markets (as mentioned above, the small direct exporters of sportswear). In rural areas, the concentration of enterprises operating in the local markets is much higher than those operating in the regional or national markets. According to the Survey, a higher proportion of women entrepreneurs operates at the regional or provincial level.

**Figure 8.1: Main markets for products and services of MSMEs, 2001**



Source: SMEDA/Gallup MSE Survey, 2001.

<sup>53</sup> The Survey sample was dominated by micro enterprises and the services and trade sector, which have a strong concentration in local markets.

### **8.3 Export and import licencing**

The Export Promotion Bureau (EPB) is attached to the Ministry of Commerce. This department's main objective is promoting and supporting sustained growth in exports of goods and services in terms of volume and value. It also acts as a registration authority for importers and exporters. Export and import licences are issued for 5 years, costing PKR 1,500 and PKR 1,530 respectively.

As far as the process of registration is concerned, there are no obvious biases in favour of large firms: the costs of compliance are not high, the procedure is not complex. The decision to obtain registration with EPB solely depends on the need to export or import. For this reason, only 12 per cent of the entrepreneurs in the SMEDA/Gallup MSE Survey were registered with the EPB. Respondents cited four factors that influenced their decision to register: 1. the licence was a government requirement; 2. the entrepreneurs had access to capital; 3. costs of compliance were very reasonable; and 4. the short time spent on registration procedures.

### **8.4 Trade regulations**

A wide array of regulations on imports and exports, with a set of procedures to be followed for compliance, have been established in the Customs Act, Sales Tax Act, import and export procedures and quota allocations. The incentive schemes and procedures related to trade financing are discussed in depth in Part 6, Finance Policy. This section concentrates on the procedures involved in exports and imports and their impact on MSMEs. To complete the picture, two case studies are presented. One deals with the textile quota allocation, the second shows globalization is affecting small-scale manufacturing in Pakistan.

Statutory regulatory orders (SRO) are issued by the Central Board of Revenue (CBR) to implement a policy decision.<sup>54</sup> A full analysis of SROs is beyond the scope of this study but those which formed the basis of certain incentives to promote exports are summarized below in relation to their impact on MSMEs.

Due to the short-term (one-year) nature of trade policy, a large number of SROs on trade are issued each year. For example, in 2000-01 the number of such procedures issued was more than 25 — all containing various amendments to existing systems, as export incentives. It would be difficult to quantify the negative effect of these frequent changes on the performance of MSMEs. However, due to lack of awareness, information gaps, low literacy levels and procedural complexities, the MSMEs show low utilization of such incentive schemes. The high number of SROs (it can reach 500) is a tremendous obstacle for the MSMEs wanting to keep up with the latest SRO schemes and to understand their content.

The general perception of the performance of government departments is very negative. Although some incidences of corruption may be exaggerated, the existence of the problem cannot be denied. Besides the set costs stated in the regulations at each stage, certain additional costs must be incurred, which increases the incidence of fixed costs. One example is the import of inputs and raw materials. An importer needs to pay as much as PKR 15,000 per shipment to get the goods cleared from port. If an exporting firm (MSME) needs to

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<sup>54</sup> Central Board of Revenue (CBR), the key tax collection agency, has under its umbrella the tax collection departments, customs departments and excise departments. All the SROs and circulars pertaining to these departments are issued by the CBR.

import inputs under special schemes,<sup>55</sup> it is required to pay additional costs (PKR 5,000 to 7,000) to get the goods cleared from the government authorities. Not only does the importer have to incur these extra costs, but the process of clearing the goods from dry-dock is very complex. From the arrival of the goods, their assessment, evaluation and final clearance, an importer needs to go through 17 steps. The greater the number of steps in a process the higher the additional costs, over and above the set costs the entrepreneur must incur. A 26-step process is shown in Annex 5.2, which also provides the amount of hidden costs entailed, under SRO 818(1)89 and SRO 554(1)98 respectively.

## **8.5 Customs tariffs**

In general, the customs tariffs in Pakistan are levied according to the cascading principle. The raw materials are at the lowest end of the value chain so the lowest tariff rates are applied to their imports, while the highest level of tariff is levied on manufactured articles. Since Pakistan is a WTO signatory and the government also plans to pursue a policy of export promotion, the maximum tariff rates are revised each year. It has recently been reduced from 35 to 30 per cent.

Tariff reduction and rationalization have a negative and a positive effect on the MSME sectors. A case in point is the government's recent reduction in the tariff of steel from 25 to 10 per cent. Exporting firms, including SMEs, which use steel as their major input, benefited from this measure. However, for sectors like small melting and steel rolling units, which were operating under tariff protection, such measures lead to the extinction of a sector and to high employment reductions. Numerous factors may come into play in tariff decisions, including international commitments, the strengthening of the economy through market-driven strategies and developing a competitive industry in order to promote exports.

Once decided, customs duty is applied mainly on an *ad valorem* basis, where often the discretionary powers of custom officials come into play. The Customs Department has the authority to evaluate and assess the value of imported goods, then apply the relevant duty. This practice gives significant authority to inspectors and appraisers; the matter is resolved through informal negotiations. These factors increase the cost for SMEs because they operate on low consumption; the increase in variable costs is much higher for small enterprises than large-scale operators.

## **8.6 Duty Draw Back and rebates: Not for MSMEs**

An exporter can claim full refund of all the duties paid during the import of raw material used in the manufacturing of export-oriented items. Duty Draw Back is reimbursed by the government. Rebate is also reimbursed to the exporter as compensation for the duties paid on imported components used in product manufacturing. The rebate rate is determined by the Ministry of Production and Industries, calculated on the amount of imported inputs used to manufacture a particular product.

As most are not direct exporters, MSMEs are unable to benefit. It is the medium and large-sized firms and the commercial exporters (which in fact only source the merchandise from local manufacturers) who reap the benefits. Even the small and medium-sized firms that are direct exporters are slightly disadvantaged, because refunds by the CBR are subject to preferential treatment. Firms in the "Gold" and "Silver" categories (described in Section 7.3.3), which operate as companies rather than as proprietorships and partnerships, have

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<sup>55</sup> Certain schemes, such as No Duty No Draw Back, permit duty-free imports of inputs to exporting firms.

preference. As the majority of the MSMEs are sole proprietorships, they face problems in obtaining their rebate refunds. Annex 5.1 shows the 21 steps involved in the No Duty No Draw Back scheme, according to SRO 818(1)89.

### **8.7 Countervailing and anti-dumping duties**

In order to protect the industry from subsidized exports and the unfair competition of dumping, the Government of Pakistan has promulgated the Anti-dumping Ordinance. This is a major area of concern for the MSMEs as they are highly vulnerable to such scenarios due to their fragmented existence and limited representation in policy-making. Dumping of products by foreign competitors completely undermines the competitive advantage of the domestic product against the imported one.

But law can only act as an effective deterrent when it is backed up with strong monitoring and implementation mechanisms. While the National Tariff Commission (NTC) has the authority to take corrective measures, its scope needs to include constant monitoring of trade if it is to provide a level playing field for the MSMEs in Pakistan. At present, there is very limited awareness among MSMEs about the role of the NTC and its functions as a guardian of the domestic industry.

### **8.8 Exchange rate policies**

The exchange rate of the Pakistani rupee (PKR) is determined by the State Bank of Pakistan. Until the early 1990s, the foreign currency and exchange rate regime was under very tight government control. In 1992 the exchange rate was shifted to a managed float system and currency trading was also allowed in the open market. Over the last years, the PKR has continuously depreciated against the US dollar.

Although SMEs show various types of flexibility to survive, they can be more vulnerable to certain external shocks such as exchange rate fluctuations, as compared to their large-scale counterparts. In the present era with its inflows and outflows of “hot money” putting pressure (in one direction or the other) on the exchange rate, the risk of damage or death to essentially healthy SMEs (healthy in the sense of their having the potential to be economically productive over a lengthy period) is high (Berry, 1999).

### **8.9 Impact of trade on two sectors: Textiles and the auto industry**

It is interesting to look at the impact of certain sector-specific policies on the MSMEs. Textiles, which is still governed by quota restrictions on global trading, is one example of an important sector, both for the economy of Pakistan and for its large MSME presence. It contributes almost 60 per cent to total export earnings and provides employment to 40 per cent of the manufacturing sector labour force. Its significance can be gauged from the fact that almost 27 per cent of the total units and employment within micro enterprises is in the textile sector.<sup>56</sup>

#### **8.9.1 Textiles: Quota policy in Pakistan**

The important global buyers of textile products including the USA, EU and Canada have imposed quota restrictions on the import of textile products from developing countries. The export quota allocated to Pakistan is managed by the government. For this purpose, it announces a quota policy to determine the dynamics of quota allocation in the textile and apparel industry. Over the past ten years, six quota policies were introduced and so far none

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<sup>56</sup> Source: Survey of Small and Household Manufacturing Industries (SHMI) 1996-97.



have seen completion. Similarly, various government policies created a provision for quota allocation for new investors for facilitating small and medium-sized entrepreneurs yet, here again, no such provision currently exists.

The textile quota policy is a good example of the policy bias in favour of large-scale firms. There is no mechanism to cater to the needs of MSMEs in terms of their growth and expansion. In the textiles and apparel industry, a sector which is truly labour-intensive and has a high proportion of MSMEs, the quota policy has imposed high barriers to entry for new small-scale investors and even restricted the capability of existing small players to diversify and grow further. This is more clearly understood in the following illustration of what happens to a small manufacturing concern.

The quota policy allows the transfer and sale of already allocated quota. The small manufacturing concern in question is, say, an apparel entrepreneur currently operating in the domestic market, who succeeds in getting an export order for 20,000 T-shirts. This small entrepreneur with a total investment in fixed assets limited to approximately PKR 20 million will be required to invest almost PKR 3.66 million in the purchase of quota from the open market.<sup>57</sup> Tremendous pressure is put on the working capital available to this small manufacturing concern, as well as a high negative impact on cost structures.

Such policy decisions not only restrict the entry of SMEs in vital manufacturing sectors but also enable the large-scale manufacturing firms to develop artificial trade barriers. Small enterprises, constrained by limited financing, are unable to compete with these giants. Such policy measures also hamper the growth of employment, especially when the economy is highly dependent upon one sector.

### ***8.9.2 The auto industry in Pakistan: Myopic vision in trade policy formulation and the negative effect on MSMEs***

The current auto industry in Pakistan owes a great part of its development to the protectionist regime under which the auto assemblers operate at high tariff protection against completely built-up units (CBUs)<sup>58</sup> imported directly. This particular feature initially attracted a number of Japanese auto manufacturers who have established their assembly plants in Pakistan to cater to the requirements of the domestic market.

In order to promote the development of the local engineering industry and to create jobs, the government devised auto industry-specific deletion programmes. These programmes stipulate targets for auto assemblers in Pakistan to source a set proportion of total components and parts from the domestic sources. As a consequence of this policy measure, around 1,000 auto parts vendors, the majority comprising MSMEs, have been created, providing employment to more than 200,000 workers.

TRIMs (Trade Related Investment Measures) refer to various restrictions and conditions imposed on foreign investment by countries in the pursuit of certain development objectives. The TRIMS (a part of the WTO) agreement which was implemented on January 1, 1995 prohibits its member states from imposing local content requirements in investment. In Pakistan, the entire small and medium-sized vendor segment is dependent upon the

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<sup>57</sup> Quota authorizes an entrepreneur to export products in a specific market, e.g. EU or the USA. This estimate is based on the quota price of PKR 2,200/dozen for T-shirt category 338 in the USA market.

<sup>58</sup> The current level of customs duty on auto cars ranges from 100 per cent to 250 per cent Ad-Valorem.

deletion<sup>59</sup> programme. Pakistan was supposed to phase out its deletion programme by January 2000, but has been able to extend it up to 2003. The future of the small vendors that manufacture components and parts for the large-scale auto giants is at stake. The complete implementation of WTO would result in closure of the majority of these small firms. This will also result in the loss of the 200,000 jobs created by this segment.

The government, in signing the TRIMs agreement, did not consider the dire repercussions for local MSMEs. Even at this late stage, no policy measure has been adopted to prepare these enterprises for the onslaught of this harsh reality of globalization and to meet the challenges they will soon be facing.

## **8.10 Observations on trade policy and regulations**

### **8.10.1 Process of trade policy formulation**

Although trade policy decisions impact negatively on the MSMEs in the manufacturing sector, they have no representation in the policy-making process. Large-scale enterprises, strongly represented by key industry and trade associations, dominate the smaller players who do not realize the importance of trade associations in protecting the rights of a given sector. Further, MSMEs in general are not recognized in the formulation of trade policy.

### **8.10.2 Inconsistency in policy measures**

The government is often blamed for being inconsistent with its policy initiatives and rightly so. One particular phenomenon within the CBR is the Statutory Regulatory Orders (SROs), which are issued whenever a new procedure is introduced or an existing procedure is modified for export and import purposes. It is never easy to forecast the life of a policy measure announced in a trade policy. One example is the tariff rate on accessories (buttons and zippers) used in the manufacture of textile and leather garments. Before the announcement of Trade Policy 2000, these items could be imported at a 35 per cent rate of duty. In the trade policy SRO of 2000, the import duty on accessories was completely abolished. Three months later, the government levied the same duty rate of 35 per cent on imports of accessories. This kind of measure undermines the performance of the MSME sector by distorting their cost structures. There have also been instances where company-specific SROs were issued, solely benefiting one firm and completely ignoring the impact on the overall industry, particularly the MSMEs.

### **8.10.3 Limited benefits to indirect exporters (MSMEs)**

Micro and small enterprises form the backbone of direct exporting firms, as they supply the finished components and semi-finished products. Due to their lack of awareness about international markets, their connectivity to international buyers, and their inability to directly tap export markets, the MSMEs working as indirect exporters are also unable to reap the benefits of certain incentives which are offered to direct exporters. Examples include:

- Rebates and indirect exporters: A fixed percentage of the total export value of products is reimbursed to the direct exporter by the government. The basic intention is to make the domestic products competitive through compensation against duties and taxes paid in import of inputs. Even if a commercial exporter is involved, rebate is claimed by the commercial exporter, whereas the process vendor (MSME) who has actually manufactured the product by using various inputs receives no rebate. Clearly,

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<sup>59</sup> Deletion is the mandatory local content requirement enforced on the auto assembly sector in Pakistan.

export development policies are more in favour of commercial exporters than the actual manufacturer or process vendor.

- Tax benefit and indirect exporters: Similarly, and regardless of their size, those units exporting 80 per cent or more of their total production do not need to file income tax returns. All their remittances reach the respective banks/financial institutions where a tax based on total turnover ranging from 0.5 per cent to 1.5 per cent<sup>60</sup> is deducted at source. This particular incentive saves the exporters from dealing with the complex procedures involved in the filing and computation of income tax returns. In practice, a large number of micro and small sized process vendors perform various processes for direct exporters but the benefit of lesser documentation and lower tax collection is not transferred to these small vendors. Even if the 100 per cent capacity of a small process vendor is dedicated to manufacturing for direct exporters, the vendor would still be required to maintain books and records, compute its income and tax liability and then file the income tax returns on an annual basis.

#### ***8.10.4 Incentives for exports***

In order to promote exports, the government has offered various incentive schemes that focus on the medium and large-scale sector.<sup>61</sup> Various incentive packages favour large-scale firms. One example, the SRO 71(1)95, provides complete waiver of customs duty and sales tax on the imports of inputs depending on firm size (employing 100 workers). This effectively bars enterprises in the micro, small and medium categories from benefiting from this incentive package. It is however worth mentioning that this SRO is meant for firms in the special industrial zones (in which there is no bar on the establishment of firms based on size). Again, this is an obvious policy bias in favour of large-scale firms.

Other similar incentive schemes, such as No Duty No Drawback (NDND) and Manufacturing in Bond (MiB) are related to temporary imports of inputs for exports and, by default, are not devised for use by MSEs. First, the MSEs are unable to establish separate warehouses in order to meet the requirements of MiB and, second, they are unable to generate the volumes which would make NDND viable for them.

#### ***8.10.5 One-window facility for exporting firms in EPZs***

One obvious discrimination between the firms operating in international markets and the firms operating in the domestic market, is the facility of a one-window operation to pay government levies. Firms operating in Export Processing Zones (EPZs) are not required to deal with individual labour departments to pay social security, employees old-age benefit contributions, etc. The Export Processing Zones Authority is responsible for the implementation of labour laws and collection of levies from firms located in EPZs. Firms operating in domestic markets have no such facility or incentive available and must deal with all the departments separately. The collection of labour levies under so many diverse regulations is a drain on entrepreneurs' productive time.

#### ***8.10.6 Policy-making and international compliance requirements***

In Pakistan, on the one hand, the government has committed to withdraw the protection given to the local small-scale vendor industry according to WTO but, on the other

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<sup>60</sup> The percentage of deduction from total turnover is based on the extent of value added in a given sector.

<sup>61</sup> According to the Gallup/BRB Survey, only 12 per cent of respondents were registered with the Export Promotion Bureau (EPB). Registration with EPB is required for both exports and imports. This underlines the MSME low presence and limited activity in direct imports and exports. However, this in no way means that MSMEs do not rely on imported inputs. Most of the MSMEs source inputs from commercial importers.

hand, the local vendor industry that manufactures parts and components for large industries has not been given any opportunity to restructure itself to deal with the demands of globalization. A sudden removal of protection will not only result in making these small ventures sick but will also significantly reduce employment.<sup>62</sup>

Such gaps in policy-making and the short-term development approach they generate raise apprehensions about the investment climate in Pakistan and prove negative for the small and medium-sized enterprises, unable to adjust to frequent changes in the policy environment.

#### ***8.10.7 Evident barriers for MSMEs***

The importance of the textiles sector and its relevance to and for the MSMEs needs no further emphasis. Nevertheless, policy measures exist which act as barriers to MSME growth and even to their entry in the textiles and apparel sector. The culprit here is quota policy. Without any special provisions for quota allocation to potential and new investors, only large-scale firms with financial muscle are able to further grow and expand in the international markets. In India and Indonesia, for example, a certain proportion of total quota is allocated to new and potential investors. This ensures the provision of a level playing field for all investors, regardless of their size.

How enabling are development initiatives in Pakistan for the MSMEs? Part 9 evaluates three incentive programmes in relation to their development objectives and their impact on the MSME sector.

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<sup>62</sup> An estimated 850 to 1,000 small auto parts vendors provide employment to more than 200,000 persons (Pakistan Auto Parts Manufacturers Association).

## **9. Enabling and innovative policies**

Enabling policies encompass a broad range of incentive programmes initiated by the government to achieve development objectives. Historically, these policies have not been targeted to the MSME sector and, as the following evaluation shows, do not focus sufficiently on the present MSME perspective.

### **9.1 Provincial support institutions and small industrial estates**

The provincial small industry development organizations established in the early 1970s developed around 46 small industrial estates in the main cities and small-industry clusters across Pakistan to facilitate small enterprise development through the provision of subsidized land and infrastructure (roads, sewage facilities, telephone, electricity).

Despite the fact that such projects were set up in all provinces, only a small segment of the MSME sector could benefit from these initiatives. First, the focus concentrated on the manufacturing sector and, second, only firms from the upper tier of the small and medium enterprise segment could invest in such industrial undertakings. Nevertheless, programmes have proved very beneficial in cluster development and the vast majority of micro enterprises were established on the peripheries of these small industrial estates.

In 1972, a Small Industry Corporation was established in each province.

- In the province of Punjab, the Punjab Small Industries Corporation (PSIC) was established as an autonomous body for the promotion and development of small-scale industry in the province. PSIC has developed 14 industrial estates in various areas of the Punjab. PSIC has also launched a “Rural Industrialization Programme” to control unemployment and strengthen the household income through the stimulation of industrial growth in urban and rural areas of Punjab.
- The Sindh Small Industries Corporation (SSIC) was established to promote small-scale industry in Sindh. The objectives of SSIC include financial assistance through a small-industry credit scheme, the education of craft workers in product designing and adaptation, a census and survey of cottage and small industries, as well as the procurement and distribution of raw material to craft workers and artisans. The SSIC has established 17 industrial estates in various areas of Sindh province.
- The NWFP Small Industries Development Board (SIDB) is playing a promotional role to support and assist the development of cottage and small industry in the province. The SIDB has also launched various Women Development Programmes and is also involved in establishing various Model Pilot Projects (e.g. centres for woodworking; for leather goods; wool-spinning; and ceramics). The SIDB has established 9 industrial estates in the NWFP province.
- In Baluchistan, the West Pakistan Small Industries Corporation was dissolved in 1972 and the affairs of the small industries sub-sector were assigned to the Directorate of Industries of the Department of Industries, Commerce and Minerals. The Directorate of Small Industries (DSI) was created in 1977 to look after all the promotional schemes for SMEs. The Directorate is also involved in providing various kinds of advisory and consultancy services.

The policy of industrial estate development played an instrumental role in the establishment of small-industry clusters such as sporting goods and surgical instrument manufacturing in Sialkot, cutlery manufacturing in Wazirabad and furniture in Gujrat. In addition, 125 training and service centres provided common processing facilities for industrial projects, training in skills development, and technical and marketing services for entrepreneurs. Until the mid-1980s, under the auspices of the small-industry organizations, these services remained effective.

Two factors were critical to their success: international donor support and professional autonomy. As soon as donor support was withdrawn and political interference became stronger, the standard of service deteriorated. For example, industrial estates established for purely political reasons in unviable areas resulted in their remaining essentially unutilized.

## **9.2 *Export processing zones: Discrimination or good practice?***

With the objective of developing a strong export industry base, the government has established export processing zones (EPZs) in various regions; one such facility has started functioning in the city of Karachi. There is no minimum limit of investment in EPZs; an industry can be established regardless of its size, the only condition being that it must export its production. The manufacturing concerns located in an EPZ benefit from duty-free imports of their inputs and the added advantage of reduced interaction with government departments. The responsibility of implementation of labour laws in the EPZ lies solely with the Export Processing Zones Authority (EPZA), relieving the entrepreneur from dealing with a number of labour departments implementing approximately 27 labour laws. The social security levies are also collected by the EPZA, again considerably lessening the time spent in interaction with government departments. On the one hand, this can be viewed as good practice, by reducing the complexities of compliance with regulations, especially labour laws. On the other hand, it can be considered discrimination against the MSMEs not operating in EPZs and unable to benefit from any incentive package that simplifies compliance with regulatory framework.

## **9.3 *The Technology Up-gradation Fund***

The Ministry of Science and Technology (MoST) has recently taken steps to facilitate the establishment of technology-driven small and medium-sized projects. It has introduced a Technology Up-gradation Fund which can also be utilized by existing SMEs for expansion and upgrading of projects. However, similarly to other government development initiatives, the delays in processing destroy the scheme's efficacy: over 700 applications have been received by MoST, but none had been evaluated or approved as of December 2001.

To encourage product standardization and to implement quality systems in the domestic industry, MoST also provides a cash incentive of PKR 150,000 to industries that receive ISO Standards certification. This one-time grant is available to all industries and sectors, regardless of size.

However, apart from these two initiatives, few specific policy measures are adopted to promote innovation and provide an enabling environment for MSMEs. It would be interesting to determine to what extent Pakistan relies for its product improvement and innovation on similar activities taking place in other parts of the developing world.

In the same vein, how effective have past institutional support systems been in nurturing MSME development in an undocumented developing economy, and how effective are they at present? The following sections take a 40-year perspective of the effect of institutional support systems in Pakistan.

#### **9.4 Institutional support systems**

The government has developed a variety of support institutions for the development of small enterprises. The development process was initiated in the 1960s, based on the “Indian Model”, with infrastructure facilities such as the industrial estates described in Section 10.1. In addition, numerous provincial-level organizations were set up, mainly with the help of foreign assistance in the form of grants and soft loans. The government has also established some financial sector organizations, some of which cater exclusively to financing the needs of the small enterprise sector. Non-governmental organizations (NGOs) have also been actively participating in SMSE development by designing programmes that address social needs on a community basis and employment generation at a micro level.

##### **9.4.1 Role of non-governmental organizations (NGOs)**

Hundreds of NGOs are working in diverse areas, including economic development, social welfare and community-based development. Besides supporting various projects directly, these organizations play an important advocacy role. According to their area of expertise, the NGOs serve as pressure groups and help the government in policy-making by providing important input on issues such as labour force development and poverty alleviation. The main NGOs and their objectives are summarized below:

- The KASHAF Foundation was established in 1996, focusing on building a durable micro finance institution with simple and effective systems, along with providing excellent customer service to an ever-growing client base. Besides providing financial assistance, it is also involved in training the micro enterprise sector and carries out research in the field of micro-credit development in Pakistan.
- Punjab Rural Support Program (PRSP) was established in 1998, with the target of overcoming poverty in rural Punjab within a decade, by actualizing the potential of the poor through a regional support programme. The system is designed to enable organizations of poor village communities by providing access to skills training, credit and technical support.
- The National Rural Support Programme (NRSP) was established in 1991 as a non-profit organization to undertake development activities in rural areas of Pakistan. Their charter is to foster a countrywide network of grassroots organizations, to enable rural communities to plan, implement and manage developmental activities for the purpose of ensuring productive employment, alleviation of poverty and improvement in the quality of life.
- The Aga Khan Rural Support Program (AKRSP) was initiated in 1982 with a broad mission to improve the productivity and welfare of people residing in the northern areas of Pakistan. AKRSP activities cover various topics: organizing village-level institutions, funding physical infrastructure projects, promoting natural resource management in agriculture, livestock and forestry, training and human resource development and marketing and enterprise development.

- Orangi is Karachi's largest *katchi abadi* (population 1.2 million).<sup>63</sup> The Orangi pilot project has set up various community-development programmes, including low-cost sanitation, housing, and education schemes to improve existing facilities for the residents of Orangi.

#### **9.4.2 Other SME support initiatives**

At the global level, the SME development focus has now shifted from direct support and infrastructure to the provision of business support services and an investigation of the role of the regulatory environment in hampering or supporting business dynamics in the MSME sector. The United States and Japan took the lead by establishing a set of customized regulations: for example, the establishment of SME regulations in Japan in 1962 and, in the United States, the development of small-business regulations and the establishment of a small-business Ombudsperson within the Small Business Administration (SBA).

However, until the late 1990s, Pakistan had no central system which could coordinate its various ME development initiatives. This lack of integration resulted in haphazard SME development in the country and achieved no significant results at a macro level. Realizing the need for a coordination mechanism, the government established the Small and Medium Enterprise Development Authority (SMEDA) in October 1998 as an autonomous organization at the federal level.

From inception, SMEDA adopted a sectoral SME development approach, selecting a few priority sectors on the basis of SME presence. In-depth research was conducted and comprehensive development plans were formulated after identifying impediments in the regulatory environment, and taking into consideration other important aspects including finance, marketing, technology and human resource development. This approach was initially adopted because it was thought that limited resources would preclude SMEDA from providing significant support services to SMEs across sectors.

In its first two years of operation, SMEDA successfully formulated sector strategies but more coverage and enhanced reach were required. SMEDA benchmarked the organizational structure and activities of similar SME international development agencies to restructure its role from a macro-level sector-specific SME development agency to a micro-level SME facilitator.

The new structure aims at developing SMEDA as an effective interface between SMEs and government. In an undocumented economy such as Pakistan, this can only be achieved through establishing linkages with industry and trade associations. These provide an ideal platform to identify collective problems faced by the SMEs and to design solutions at the cluster level. SMEDA's development strategy will now be lead by a needs assessment study of SMEs, based on interaction with industry and trade associations.

Since its restructuring, SMEDA's external focus is on six support services for the SMEs that have been established through SMEDA's Outreach programme; extensive human resource development programmes are part of each support function. The internal focus relates to sector strategy development, wherein each support function is responsible for providing input in its area of expertise.

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<sup>63</sup> *Katchi Abadi* refers to spontaneous settlements which are not included in urban planning and therefore do not have proper facilities (roads, drinking-water, drainage, sewerage).



An important feature of the restructuring is to exploit the potential of existing sectoral research through the development of small and medium-sized projects. Efforts are underway on a fast-track basis to identify projects and develop bankable business plans. This is vital to ensure the provision of business development services at the micro level and to bridge the gap between the financial institutions and the SMEs.

Part 10 presents the conclusions of this report on the impact of policy and what measures are being taken to sustain a policy environment conducive to growth of the MSME sector — the major, albeit unacknowledged, source of employment in Pakistan.

## 10. Conclusions

### 10.1 *Employment and job quality*

Although detailed and longitudinal data on employment in different classes of enterprises (micro, small, medium) in different economic sectors including manufacturing, trade and services are not available, some authentic sources reveal that almost 80 per cent<sup>64</sup> of non-agricultural employment in Pakistan is generated by the MSMEs. The SHMI<sup>65</sup> reveals that the employment in manufacturing micro enterprises increased by an annual average rate of more than 6 per cent from 1988 to 1997. The Gallup/BRB Survey, 2001 demonstrated that in the sample enterprises covered in a two-year time-frame, employment increased almost 14 per cent (an annual average growth rate of 7 per cent, which corresponds to the SHMI estimates).

Another important aspect is the determination of factors that lead to creation of these firms. According to the SMEDA/Gallup MSE Survey, 2001 very few (9 per cent) enterprises were started in lieu of appropriate employment opportunities. The main reason for start-ups given by respondents was the sovereignty and independence gained by managing their own business. It would appear that the vast majority of MSMEs are established because of strong entrepreneurial drive rather than as a survival strategy in conditions of excess labour supply. Respondents took the decision to start their business based on response to market demand for services and products.

In terms of the quality of employment, MSMEs provide basic facilities that constitute the elements of a better working environment (provision of drinking-water, improved work conditions). However, written employment contracts, pensions, insurance, maternity/paternity benefits are generally not provided to employees in the MSMEs. A large majority of employees, regardless of enterprise size, are working as full-time permanent employees. They do not enjoy the benefits of full-time employees in large-scale enterprises in the organized sector (social protection, hospitalization coverage, retirement benefits and assistance in child education subsidized by employers and government). The contributing factors to better job quality in large-scale firms are compliance with government regulations, the right to collective bargaining and, to some extent, stringent monitoring and implementation of laws due to the size and location of the enterprise. Until recently, micro enterprises were completely exempt from all the labour regulations, which negatively affected job quality in most MSMEs. Even the enterprises with 10 or more employees, which are required by law to be registered with labour departments, often remain unregistered.<sup>66</sup>

### 10.2 *Employment generation and the policy environment*

It is generally assumed that the MSMEs are unable to achieve sustainable development on their own resources and require public intervention at all stages of their development. It is also assumed that these enterprises respond quickly to public-sector support initiatives, meaning that employment growth in these enterprises is, or should be, highly dependent on government policies. Interestingly, the SMEDA/Gallup MSE Survey

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<sup>64</sup> Census of Establishments, 1988.

<sup>65</sup> Survey of Household and Manufacturing Industries, 1987-88; 1996-97.

<sup>66</sup> According to Gallup/BRB Survey 14 per cent of the respondents were registered with the Employees Old Age Benefit Institution (EOBI) and only 8 per cent were registered with the Employee Social Security Institutions (ESSI). 50 per cent of the sample contained firms which employed 10 or more employees.

revealed that the MSME response to market demand<sup>67</sup> is the single most important factor in their decisions on increasing or decreasing workers, on improving the quality of employment and on enterprise investment. As the market demand for a product or service increases, the entrepreneur responds by increasing production and will do so if the necessary financial and human resources needed to step up production and delivery are available or accessible. According to respondents, government policies, labour regulations and special incentive programmes have only a limited influence on their decision-making. This influence increases with enterprise size.<sup>68</sup> Most micro enterprises operate in the informal sector and are not required to comply with labour regulations, whereas the small and medium-sized firms that operate as formal sector enterprises and comply with labour regulations are more influenced by government policy when taking decisions to increase or decrease workers. Taxation, labour policy and remuneration rated as the main factors in respondents' decisions to decrease their number of employees.

Similarly, decisions by entrepreneurs on conditions of work were highly dependent on enterprise performance, linked strongly to market demand.<sup>69</sup> However, factors like business premises, access to financial resources and inputs other than market demand also have a positive influence on decisions to improve working conditions. In the small and medium firms, the labour regulations also appear to have a positive influence in these decisions.

Market demand for product or services also plays a dominant role in respondents' decisions to invest in expanding or upgrading existing facilities. Other factors, such as business premises and access to finance, also have a positive influence on the decision to invest for small and medium enterprises, but can negatively affect the investment decision of the micro enterprise.

In sum, the extent to which the policy environment and regulations negatively affect the MSMEs depends heavily upon the size of an enterprise. The micro enterprises display indifference or perceive themselves as uninfluenced by the policy environment and regulatory framework, while small and medium-sized enterprises can be negatively affected, creating impediments to employment growth.

### **10.3 The regulatory framework**

As Figure 10.1 shows, some features of policy-making in Pakistan shape the regulatory environment and its impact on MSME growth.

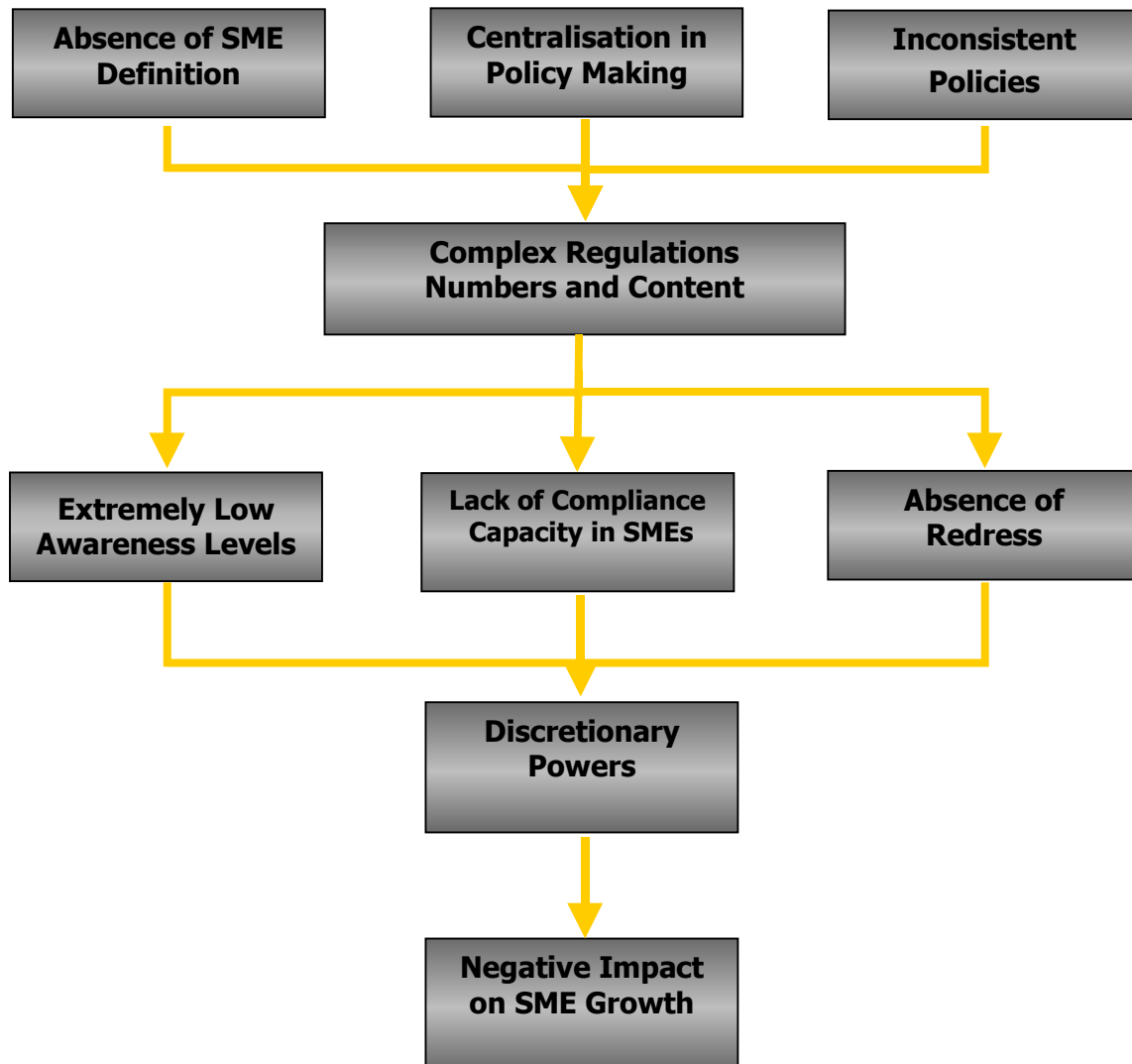
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<sup>67</sup> Market demand was highlighted by 41 per cent of the respondents as the single most critical factor in decision to increase, decrease or maintain the labour force (Gallup/BRB Survey). 58 per cent of respondents mentioned that market demand had either a strong positive or a positive influence on their decision to increase or decrease workers.

<sup>68</sup> The Gallup/BRB Survey found that 24 per cent of respondents in small enterprises and 26 per cent in medium enterprises reported government policies as having a strong positive or positive influence on employment decisions.

<sup>69</sup> 61 per cent of respondents in the Gallup/BRB Survey mentioned that markets play either a strong positive or positive role in their decisions on working conditions.

*Figure 10.1: Regulatory environment for SMEs in Pakistan*



*Source: SMEDA, 2001.*

Policies are formulated by the federal government and implemented through various procedures and rules of provincial governments. The labour laws, for example, are formulated federally, with inputs from all the provinces, but it is difficult to tailor them according to the local needs of province-based small and medium enterprises.

Various policies depict certain inconsistencies due to their short-term nature. An ideal example is trade policy, which is announced yearly and yet constantly being amended by a stream of SROs — making it almost impossible for the MSMEs to keep pace with changes in the regulatory environment.

Another factor which aggravates the situation is the absence of a uniform definition for MSMEs. It has been repeatedly observed in this report that programmes are developed by the government without qualifying the term MSMEs. Pakistan has not yet reached the stage of designing a policy of promotion and development specifically devised to meet the requirements of MSMEs.

This complexity of the regulatory process and the gaps in policy-making take their toll on the disadvantaged MSME sector in the cumbersome procedures and regulations to be dealt with. Considering the low literacy levels<sup>70</sup> of the population, the problem is compounded not only by the sometimes daunting number of steps required for compliance but their unnecessarily over-complicated wording in English. Urdu should be the language of choice.

In addition, due to the fragmented nature of MSMEs, the frequent changes in compliance procedures, and their limited awareness of regulatory processes, entrepreneurs are unable to keep pace with the necessary information. Familiarity, even with the basic requirements of various acts and regulations, is lacking, especially in the micro enterprises and those in the lower rung of the small enterprise segment.<sup>71</sup>

This, coupled with lack of capacity for compliance in the MSMEs and their lack of redress, leads to undue pressures on entrepreneurs, who resort to settling these matters by paying “speed money”<sup>72</sup> to officials. Discretionary powers can pose a real problem for vulnerable MSMEs without the management capacities to comprehend the complexities of the regulatory framework or deal with administrative mechanisms.

Clearly, these are obstacles to the MSME enterprises and the government: MSMEs remain operating in the informal sector — because of their lack of awareness of regulatory procedures and also because of their wish to avoid compliance requirements. When the MSMEs succeed in increasing their turnover and employment, it is in response to market demand; government regulations play a dormant role in their growth.<sup>73</sup>

#### **10.4 The conducive environment**

The main elements of a conducive environment for MSMEs are awareness of the regulatory regime, the availability of information, consistency in policies, and transparency in the implementation of regulations and policy measures.

As Figure 10.2 shows, the SMEDA/Gallup MSE Survey rated these elements for nurturing MSME growth on a scale of 1 to 10: the lower the rating, the higher the need for improvement. For respondents, the main priorities were the lack of basic knowledge and accessible information on regulations, developments and incentive schemes; the poor representation of MSMEs in industry and trade associations (70 to 77 per cent of respondents were not members of any chamber of commerce or industry/trade association); and corruption. Entrepreneurs rated policy applications as consistently fanning out from the central to the provincial level.

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<sup>70</sup> Only 46 per cent of the total population is literate. In Pakistan, the minimum literacy level is defined as the capability to write one's name.

<sup>71</sup> Observed in SMEDA focus groups in all provinces. Moreover, about 90 per cent of the Gallup/BRB Survey respondents who were unregistered with the Employees Social Security Institutions showed indifference to the regulations (“No Influence”), ranging from 58 per cent to 74 per cent on various options including costs, time and reporting requirements. (Reporting requirements rated highest, at 74 per cent).

<sup>72</sup> As explained in Part 9 on trade policy, at each stage of import, certain rates have been fixed by the customs department in order to get the goods released from dry-dock. These costs are over and above the actual costs established by law.

<sup>73</sup> Almost 59 per cent of respondents in the Gallup/BRB Survey cited market demand as a strong positive or positive influence on their decisions to increase or decrease employment. The influence of taxation, government policy and labour regulations was rated very low.

According to the survey results, the average score of all conducive elements is slightly above three, leaving a great deal of room for improvement in the policy environment for MSMEs in Pakistan.<sup>74</sup>

**Figure 10.2: Elements of a conducive environment for MSMEs in Pakistan**

Factors in a Conducive Environment	1	2	3	4	5	6	7	8	9	10
Policies and laws are not contradictory and easily understood by MSMEs	■									
Administrative decisions are not arbitrary and decision made on objective criteria Corruption is absent	■									
Information on policies is widely and readily available to MSMEs	■									
MSMEs are fully aware of policies and laws applicable and incentives available	■									
Policies and laws applicable are consistently applied from central to national level	■									
MSMEs are well represented through industry and trade associations in policy making	■									

Source: SMEDA, 2001.

### 10.5 MSME perception of government policies

To survive and remain healthy, MSME enterprises must react swiftly to market demand. In the SMEDA/Gallup MSE Survey, 2001 respondents based their negative perception of government regulations on the slow, cumbersome documentation procedure; the costs that are incurred over and above the established (actual) costs; and the amount of entrepreneurial time spent in compliance with regulations enforced by the government.<sup>75</sup>

These findings corroborate a recent study on SMEs in Pakistan conducted by the World Bank (World Bank, 2001). Some salient findings were:

- Small entrepreneurs spend, on average, over PKR 15,000 per year and 12 per cent of their entrepreneurial time in coping with government regulations, over and above time spent on what they considered “legitimate government demands”. This amounts to around 36<sup>76</sup> days a year spent on resolving problems associated only with government departments, considering that the majority of micro and small enterprises are self-managed by the owner and that usually no well-defined management structures are in place.
- More than 90 per cent of respondents cited government hurdles that affected the smoother functioning of their enterprise. These were rated as: the rising cost of

<sup>74</sup> In response to various factors influencing business performance besides market demand and competition, “too many regulations and restrictions” were highlighted as the second most important impediment to enterprise growth (Gallup/BRB Survey, 2001).

<sup>75</sup> Entrepreneurs not registered with government departments stated that fines, harassment and reporting requirements as factors that had a strong negative influence on their decision to remain unregistered (Gallup/BRB Survey, 2001).

<sup>76</sup> Calculated on the basis of 300 working days per year.

business due to government taxes (56 per cent), corruption (39 per cent), enhanced utility charges (30 per cent) and the “oppressive” role of local officials (26 per cent).

In sum, the entrepreneurial time and effort expended on dealing with regulations and government departments were seen impeding on productivity.

### **10.6 Regulations and their impact on employment and job quality in MSMEs**

Given that the employment growth in the MSMEs is directly related to enterprise performance, any increase or decrease in workers in an enterprise is affected by market demand more than any other factor. The negative perception of government policies described above affects workers when non-compliance with regulations results in lower job quality. An example is the social safety net provisions of the Employees Social Security Institution (ESSI) and the Employees Old Age Benefit Institutions (EOBI). The former was established to provide employees with social coverage for medical facilities during employment and the latter to provide a pension upon retirement. Compliance with both these schemes is very low in the small and medium enterprises. The micro enterprises (employing less than 10 workers)<sup>77</sup> are not required to comply with the requirements of ESSI. As a consequence a large proportion of the labour force in this segment works without social coverage, which deteriorates job quality (for more details, see Part 5, Labour policy).

The results of the SMEDA/Gallup MSE Survey, 2001<sup>78</sup> further strengthen the hypothesis of a negative perception of government policies and avoidance of compliance with regulations. Only 14 per cent of respondents were registered with the EOBI and 8 per cent with the ESSI. The reasons given for not registering for the safety net were: the reporting requirements, fines, and the harassment imposed by these departments. A large number of respondents showed indifference to the schemes and strongly doubted the efficacy of various programmes initiated by the government.

Avoidance and non-compliance with regulations forces employees to work without social coverage, even though this does not necessarily have a similar negative effect on workers’ wages and their conditions of work.<sup>79</sup>

Further evidence of the negative perception of government policies discussed earlier is observed in the negative reaction of the business community to the massive documentation drive started by the tax authorities in July 2000. The objective was to broaden the tax net through capturing the informal sector and curbing tax evasion. This drive triggered a series of nationwide strikes in the trade and services and manufacturing sectors.

The business community claims that they are willing to contribute to the Exchequer, provided the benefits to employees are guaranteed.<sup>80</sup> For example, the performance record of the ESSI and the EOBI shows that the coverage of these schemes is very limited. There have also been instances where some institutions have deviated from their main objective, which is to support the labour force. The concern here is that the greater share of the annual income of

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<sup>77</sup> In August 2001 with the announcement of new labour policy, the minimum for compliance with the ESSI has been reduced from 9 workers to 5 workers on the self-assessment basis.

<sup>78</sup> The sample included 154 micro enterprises, the remainder employed between 10 to 49 workers.

<sup>79</sup> Gallup/BRB Survey results found that market demand for products/services has a positive effect on the entrepreneurs’ decisions to improve working conditions for employees.

<sup>80</sup> SMEDA focus group Sialkot, entrepreneurs referred to the embezzlement of public funds and to non-development expenditure.

such institutions should be spent on employee welfare rather than any other programme. Such lapses in implementation of policies raise doubts about government support programmes and discourage employers from entering the formal sector.

### **10.7 Policy-making for MSMEs in Pakistan: Best practices**

The existing policy framework, both at the federal and the provincial level is functionally aligned to assist all sectors in the economy. SMEDA has been assigned to act as a policy advisory body to the Government of Pakistan at the federal level. However, no mechanism exists to ensure the representation of SMEs in policy formulating. The result is haphazard policy development and resource wastage. Lack of coordination often produces overlapping in various areas of SME development. For example, the provincial small enterprise development organizations are involved in the implementation of development projects with limited participation in policy formulation. Exclusive responsibility for the provision of a conducive environment at the macro level for the MSMEs has not yet been assigned to any government department or agency.

It is worthy of note that in 1963 the Government of Japan, after defining SMEs, adopted the “SME Basic Law”,<sup>81</sup> stressing the importance of SMEs and providing guidelines for structured SME development. For this purpose a Small and Medium Enterprise Agency (SMEA) was assigned to regulate the law and coordinate development efforts with both federal and local governments. The Japanese SME law has defined the term “SME” and its definition is accepted nationwide. Even policy measures and incentives in concessional tax rates and credit guarantees are designed and implemented according to pre-defined, set criteria. The Japanese SME development model, combining targeted regulations and a focused establishment of institutions, is an ideal benchmark or best practice to provide a policy environment conducive to sustainable SME growth.

Throughout this report, it has been noted that in numerous policy areas MSMEs are confronted with problems in dealing with regulations. These include compliance issues on a basic understanding of implementation of regulations, on transparency and on the costs of compliance with regulations. This requires a highly focused approach that will develop an MSME-specific policy across all functional areas, including finance, taxation, trade, business operations, innovation and enabling regulations. The following extract cites the challenges in targeting small and medium enterprises but equally relates to micro enterprises and their sustainability for employment growth.

“SMEs face special challenges — but also special opportunities. SMEs are important for the economy, particularly job creation. So, is that not enough justification for implementing SME policies? The answer is No — it does not warrant providing support simply “to help SMEs”. One cannot sufficiently emphasize the importance for governments of taking the concept of rationale seriously. Special SME polices or programmes should be adopted only to the extent that there is a particular rationale for doing so. And, in many cases, there is — in the form of market, government or systemic failures”.<sup>82</sup> On that note, this report concludes, with the hope that it will help to create a policy environment conducive to sustainable employment growth in MSMEs in Pakistan.

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<sup>81</sup> “Guide to small and medium size enterprise policies in Japan” (JETRO).

<sup>82</sup> Policy Design, Implementation and Evaluation — Rationale, Efficiency and Systemic Concerns. Presented by Thomas Anderson at OECD SME Forum (Lisbon, April 13-14, 2000), pp. 3 and 4.



## Annex 1: Economic overview

### ***Chronology of Key Events Affecting Economic Performance of Pakistan***

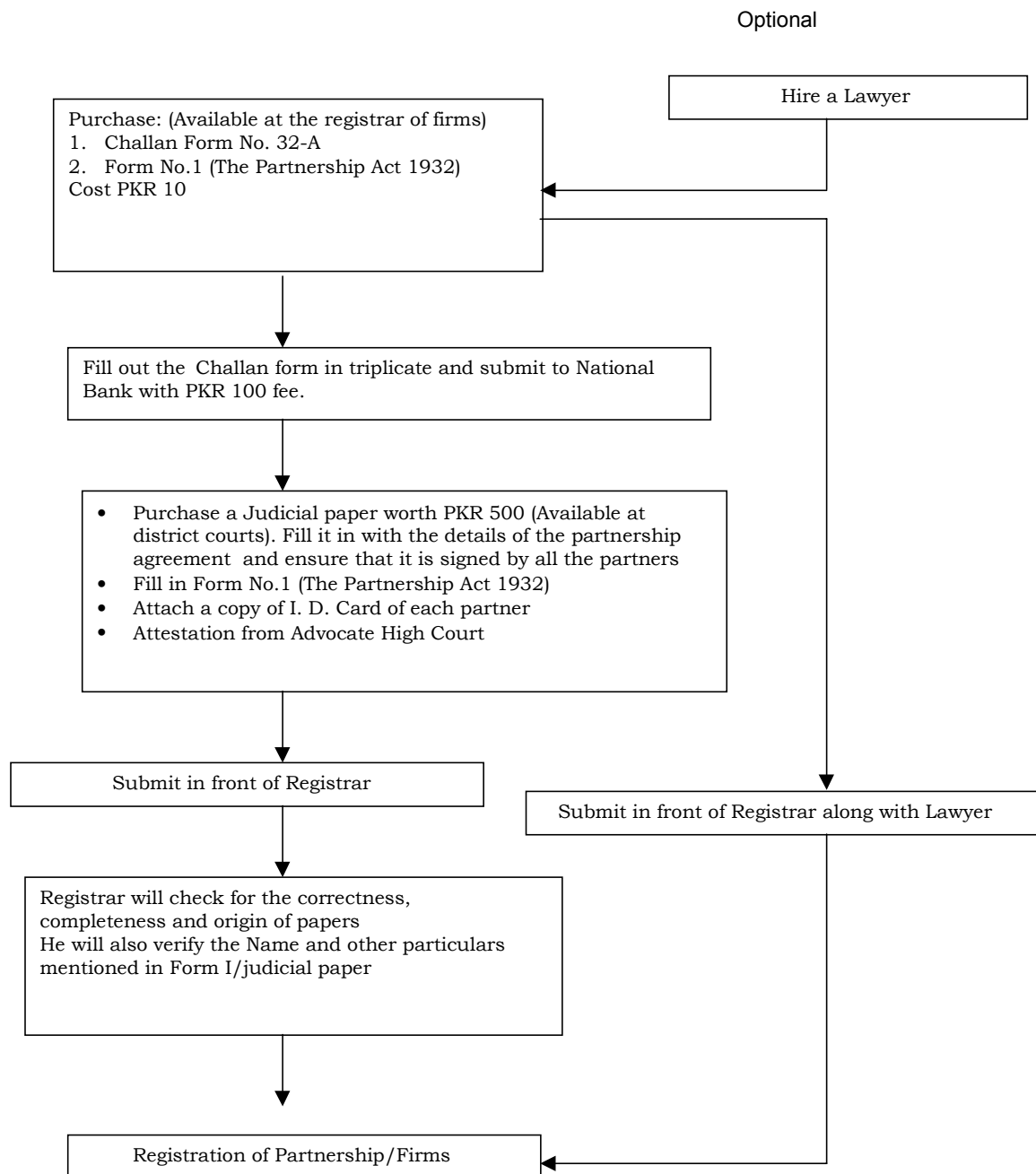
<b>Year</b>	<b>Events</b>
1963	Export Promotion Bureau (EPB) was established to promote export culture in Pakistan.
1972	Major industries are nationalized including iron and basic metals, heavy engineering, automobile, chemicals, petroleum, cement, utilities and shipping. Establishment of specialized institutions for the promotion of small-scale and cottage industry such as Punjab Small Industrial Corporation (PSIC), Sindh Small Industrial Corporation (SSIC), NWFP Small Industries Development Board (SIDB) and Small Business Finance Corporation (SBFC). Labour reforms were introduced for the first time in Pakistan.
1973	The Banks Nationalisation Act is introduced to consolidate private sector banks and bring them under public ownership.
1982	The Pakistani rupee is placed on a managed float.
1983	The Sixth Five Year Plan (1983 – 88) is launched with privatization and deregulation as its central themes.
1984	The Companies Ordinance is promulgated to regulate the private and public corporations in the country. The Corporate Law Authority is created.
1985	The Banking & Financial Services Ordinance is introduced to bring the financial sector into accordance with the tenets of Islam. Measures like non-interest based, risk-sharing system are introduced in the banking system, as well as the creation of Islamic modes of financing such as Modarabas and Morabahas. The National Dis-investment Authority is created. The Pakistan rupee is made partially convertible with the introduction of Foreign Exchange Bearer Certificates.
1986	The government grants permission to set up privately owned commercial banks.
1987	The Nationalisation Ordinance, 1973 is amended, eliminating requirements that state-owned enterprises must be offered for sale to their previous owners. Investment banks are allowed to operate in the local financial sector.
1989	The Board of Investment is created to promote foreign and domestic investment in the country.
1991	Privatisation Commission created with the responsibility of privatizing industrial projects and financial institutions. Muslim Commercial Bank and Allied Bank of Pakistan are privatized.
1992	New Prudential regulations are issued for the banking system. The rupee is made freely convertible. Repatriation of capital by foreign investors is allowed.
1996	The Pakistan Banking Council is dissolved by the government. Commercial banks are allowed to provide fund management and investment advisory services.
1998	Small and Medium Enterprises Development Authority (SMEDA) established.

*Source: SMEDA.*

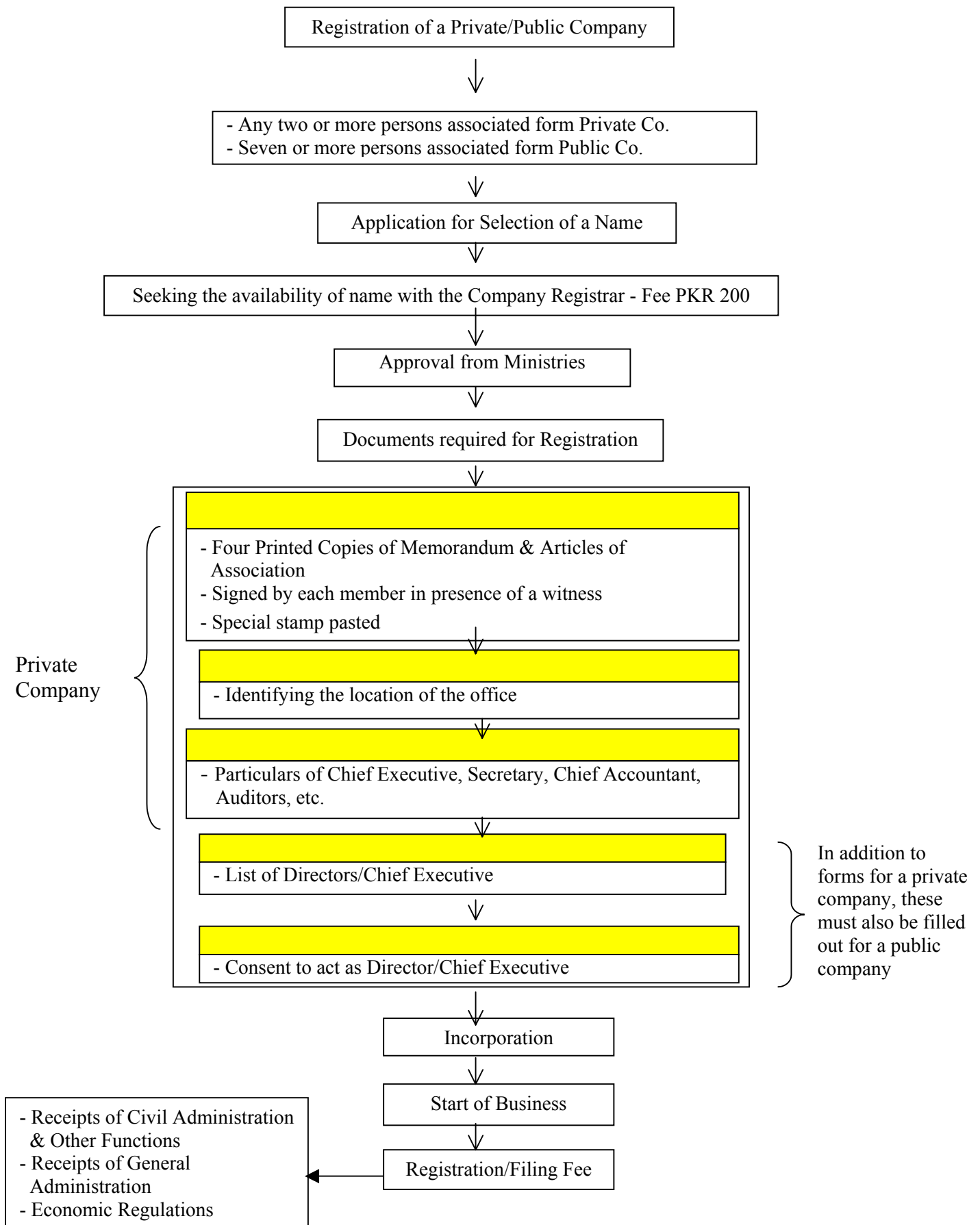


## Annex 2: Business laws and regulations

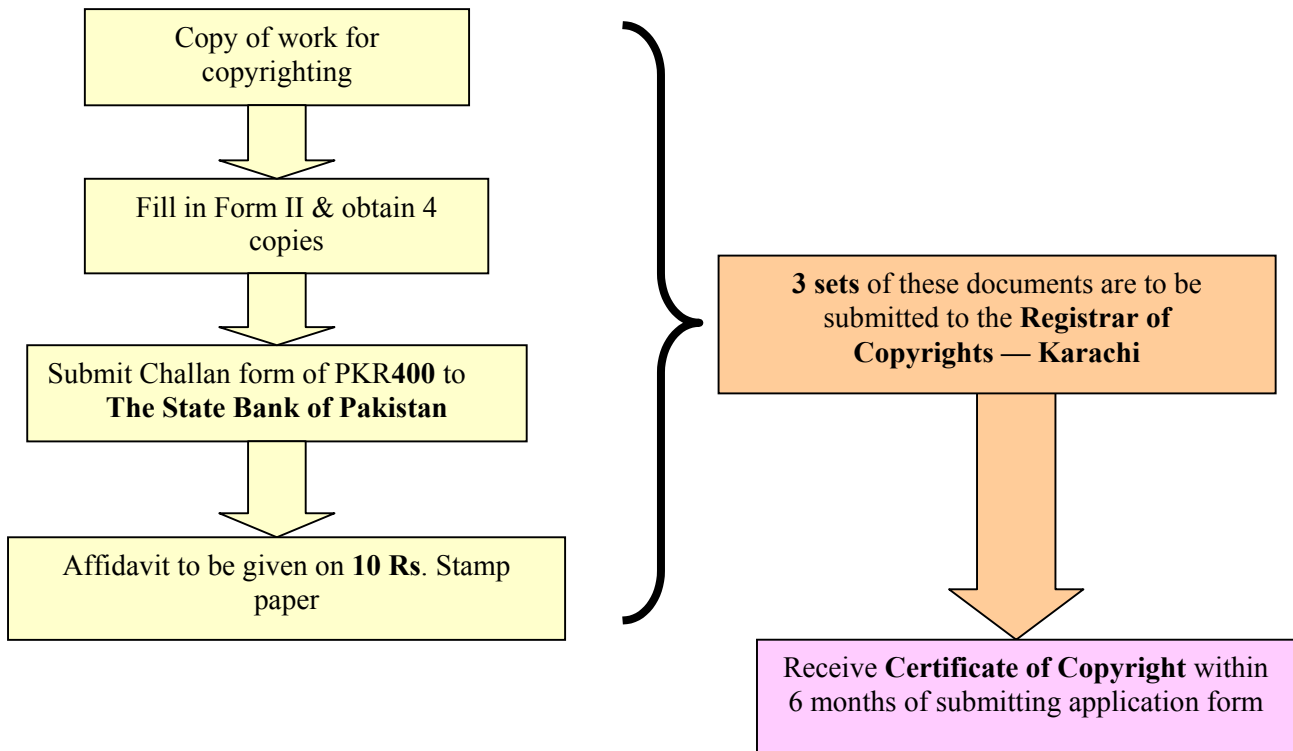
### 2.1: Flow Chart For Partnership Registration



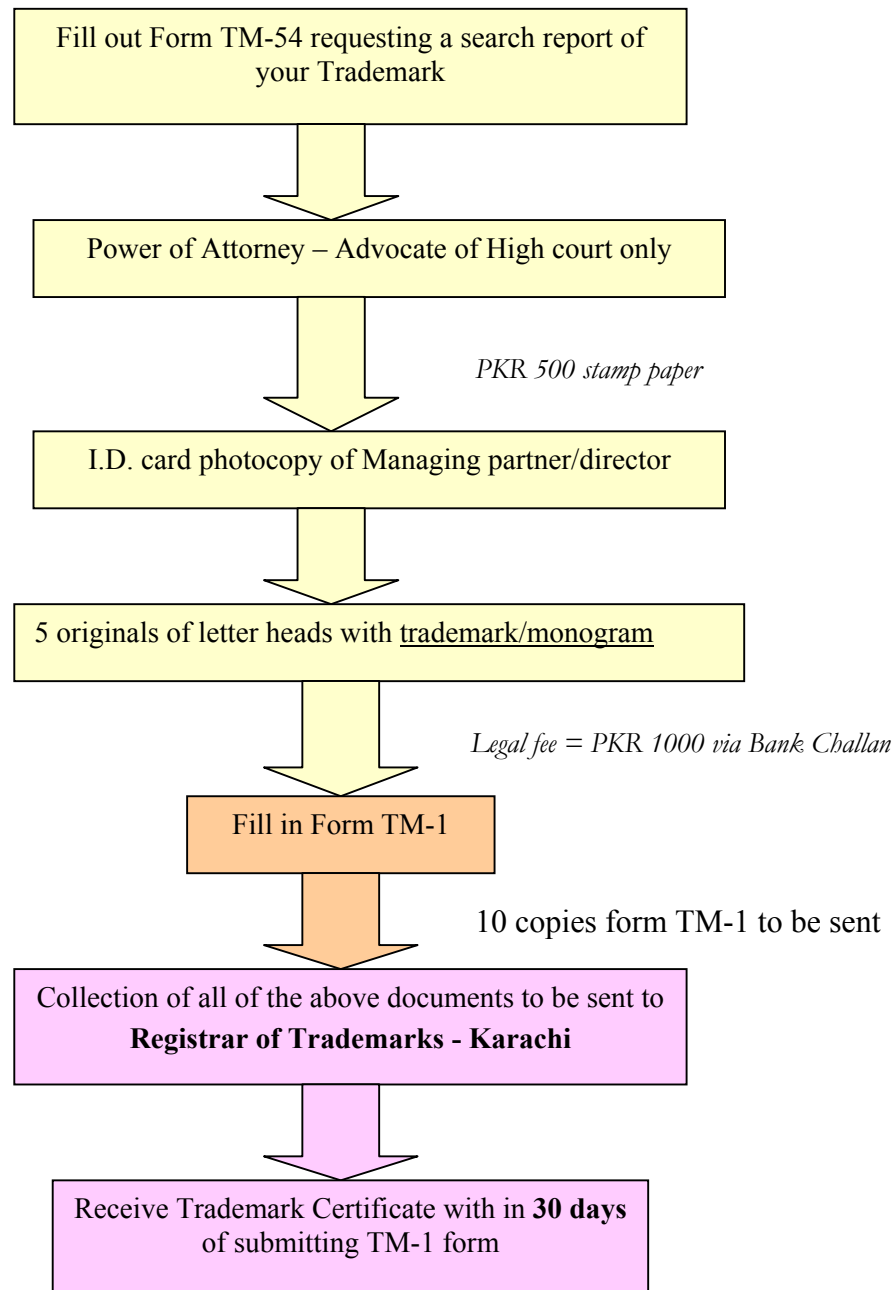
## 2.2 Flow Chart for Company Registration



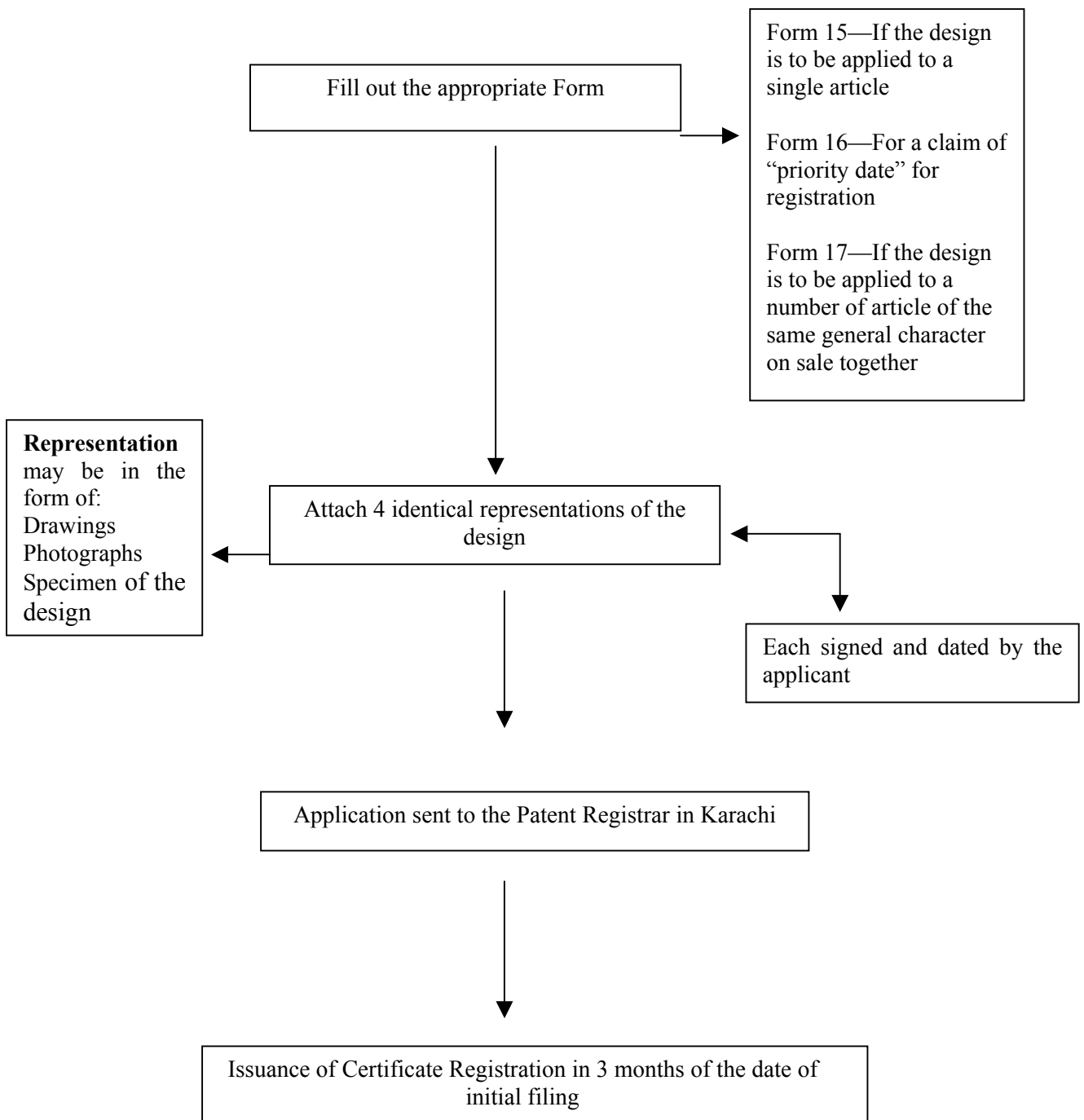
### 2.3 Flow Chart For Copyright Registration



## 2.4 Flow Chart For Trademark Registration



## 2.5 Flow Chart For Patent Registration







## Annex 3: Labour policy

### 3.1 Performance indicators of ESSI

Description	1996-97	1998-99
% of total admin. spent on admin. salaries	83%	84%
% of income on spent administration	39%	40%
<b>% of income spent on workers covered by scheme</b>	53%	64%
Admin. exp. to expenditure welfare (ratio)	-	0.53
Total number of persons covered/total staff	92.47	87.10
Percentage of employees covered by ESSI	2.23%	1.93%
Percentage of formal non-agricultural sector workers covered	10.77%	-
Percentage of non-agricultural sector workers covered	3.81%	-
Percentage of contributions spent on cash benefits	54.9%	65.9%

Source: Finance Division, Government of Pakistan, Report of the Task Force on Labour Welfare Levies, 2000.

### 3.2 Employees' Social Security Institution (ESSI)

Variables	1996-97	1998-99	Difference
Total number of workers covered	725,719	717,471	- 8,248
<b>Total number of officers/staff</b>	7,848	8,237	389
Administrative exp. (salaries & allowances)	422,444,612	513,314,413	90,869,801
Total administrative expenditure	508,806,042	614,724,418	105,918,375
Contributions	1,274,730,370	1,476,831,182	202,100,812
Total income	1,313,747,597	1,518,177,179	204,429,582
Total amount spent on workers covered	699,676,626	973,922,585	274,245,960
Per capita exp. (workers covered) per year	964	1,357	393
Per capita total admin. exp.	701	857	156

Source: Finance Division, Government of Pakistan, Report of the Task Force on Labour Welfare Levies, 2000.

### 3.3 Educational CESS comparisons of income and expenditure

<b>Punjab</b>			
Year	96-97	97-98	
Collection	44,405,548	44,947,630	
No. of workers contributing	444,055	449,476	
No. of beneficiaries	5,546	5,596	
% of utilization of educational CESS	1.249%	1.245%	
Expenditure through schools	31,348,000	36,913,450	
% of collection spent on expenditure	70.6%	82.13%	
Growth in welfare expenditure (96-98)	8.51%		
Growth in welfare collection (96-98)	0.61%		
Growth in number of beneficiaries(96-98)	0.45%		
<b>N.W.F.P</b>			
Year	96-97	97-98	98-99
Collection	5,202,221	5,466,485	4,656,629
No. of workers contributing	52,022	54,665	46,566
No. of beneficiaries	12,451	12,124	6,912
% of utilization of educational CESS	23.9%	22.2%	14.8%
Amount spent on education of workers' children	4,707,940	4,652,005	2,796,840
% of collection spent on educational welfare	90.5%	85.1%	60.1%
Growth in welfare expenditure (96-99)	-16%		
Growth in welfare collection (96-99)	-4%		
Growth in number of beneficiaries(96-99)	-18%		
<b>Baluchistan</b>			
Year	1973-99		
Collection	9,510,258		
No. of workers contributing	95,103		
No. of beneficiaries	1,526		
% of utilization of educational CESS	1.605%		
Expenditure on children	5,738,035		
Collection to expenditure ratio (73-99)	60.34%		

Source: Finance Division, Government of Pakistan, Report of the Task Force on Labour Welfare Levies, 2000.

### 3.4 Performance of Employees' Old Age Benefit Institution (EOBI)

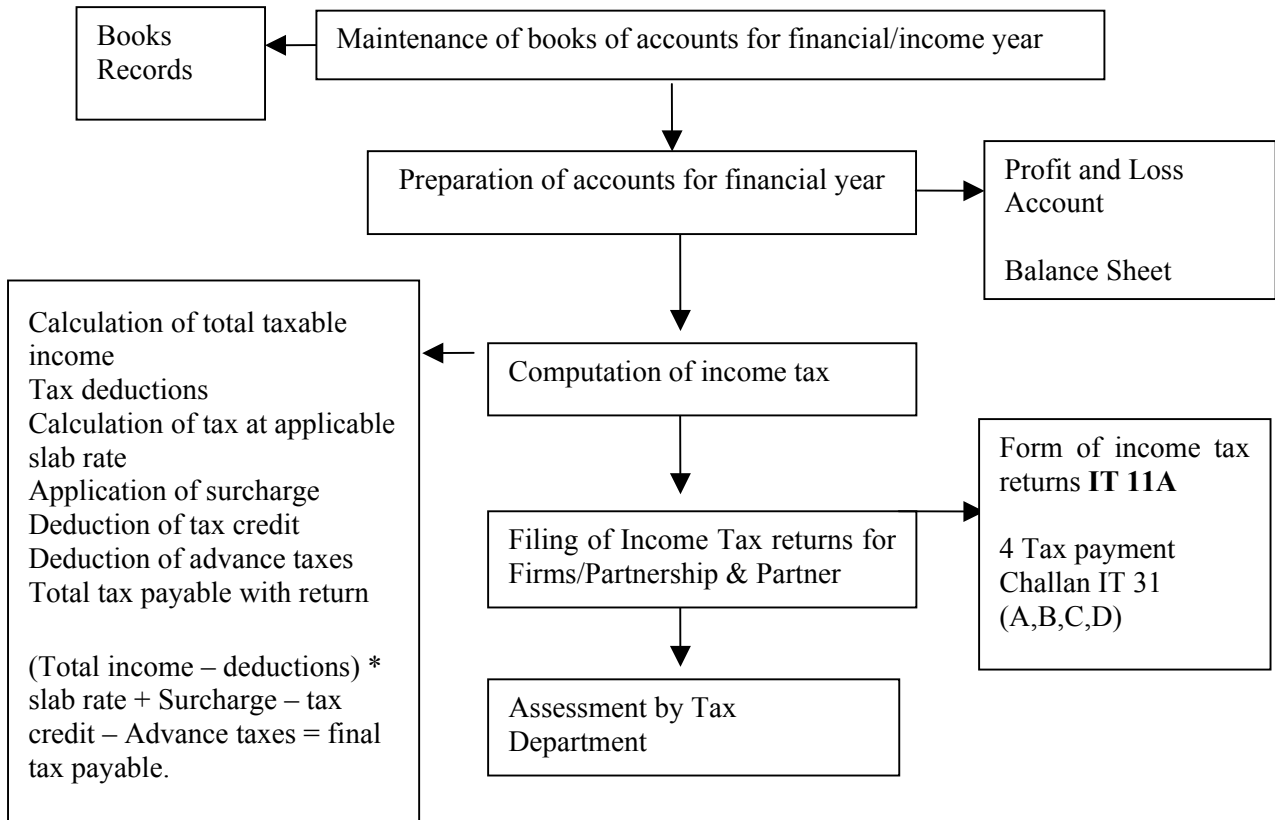
<b>Variables</b>	<b>Up to 1999</b>
Total number of employers registered	42,632
<b>Total number of pensioners</b>	164,203
Total amount paid as pension	5.53 (billion PKR)
Total EOBI fund	39.03 (billion PKR)
% of income on admin. expenditure	3.53%
% of income on pensioners	11.6%
% of income on total expenditure	15.15%
% of income reinvested	84.85%
Growth income (incl. profits, contributions, grants, etc.)	10.15%
Growth in total contribution	3.64%
Growth in admin. expenditure	6.79%
Expenditure to total receipts (96-99)	4.0%
Total admin. expenditure to total contribution from employers (96-97)	14.7%
Total admin. expenditure to total contribution from employers (98-99)	16.1%
Payment (benefits) to total income (96-99)	11.0%

*Source: Finance Division, Government of Pakistan, Report of the Task Force on Labour Welfare Levies, 2000.*

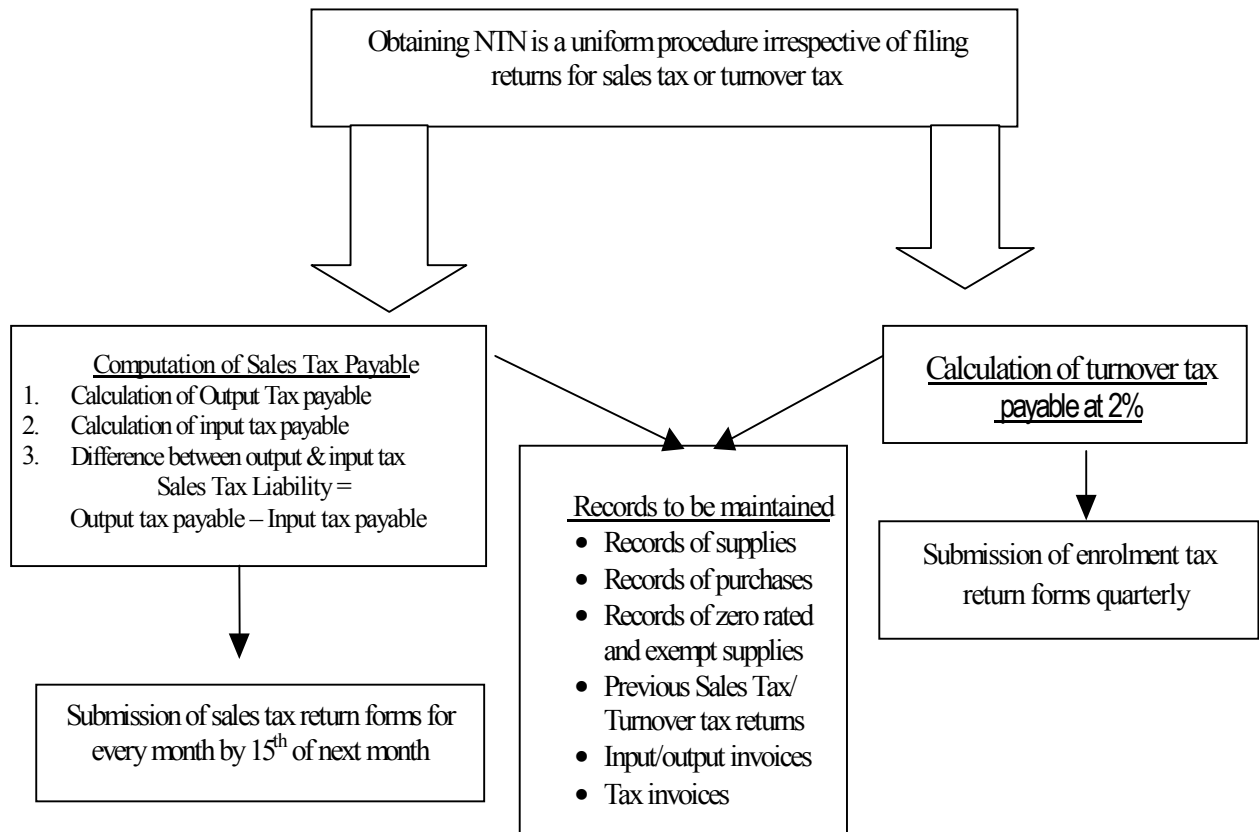


## Annex 4: Taxation

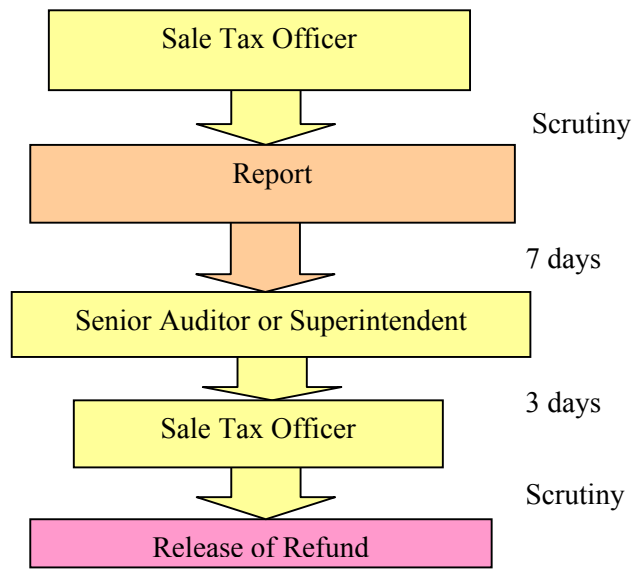
### 4.1 Procedure For Filing Income Tax Returns



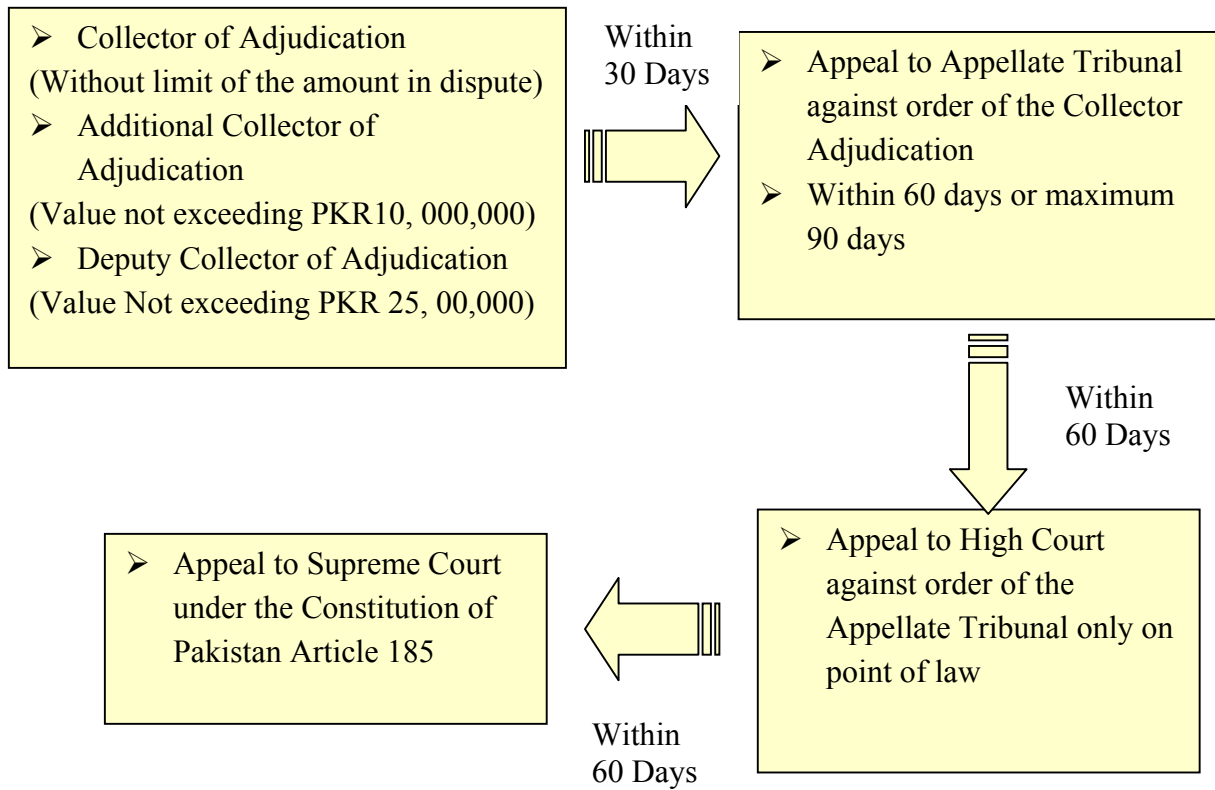
## 4.2 Sales and Turnover Tax: Procedure for Computation and Submission of Return Forms



### 4.3 Procedure for Refund of Sales Tax



#### 4.4 Adjudication under Sales Tax Act 1990





## Annex 5: Trade Policy

### 5.1 No Duty No Draw Back Scheme: SRO 818(1)89

Sr.#	Process flow of steps required for Statutory Regulatory Ordinance 818
	Clearing agent submits following documents to upper division clerk: Bill of Entry Bill of Lading or Airway Bill Invoice Indemnity Bond/Bank Guarantee with Post Dated Cheque (PDC) Income Tax Certificate
1	<b>Upper division clerk files documents, allots MFG Number of file, and writes its details in Inward Register</b>
2	Upper division clerk fills details in Performa and attaches it with file
3	Appraiser verifies Bill of Entry, and assesses values mentioned in : Invoice Examination Report Appraiser also checks Indemnity Bond values
4	Appraiser decides upon nature of discrepancy found in submitted documents. If required, documents are returned to Clearing Agent for necessary corrections
5	Appraiser corrects the discrepancy in the Bill of Entry, if possible
6	Appraiser signs verified Bill of Entry and forwards to Principal Appraiser
7	Principal Appraiser further verifies Bill of Entry and Indemnity Bond/Bank Guarantee
8	Principal Appraiser, in case of any discrepancy, writes objections on the reverse side of the Bill of Entry and marks file to Appraiser or Clearing Agent, whoever is responsible for its removal
9	Principal appraiser, if satisfied, signs Bill of Entry and forwards to Assistant Collector
10	Assistant Collector verifies Indemnity Bond/Bank Guarantee status
11	Assistant Collector writes objection and returns it to the clearing agent if any discrepancy is found in Indemnity Bond/Bank Guarantee
12	Assistant collector signs file and forwards it to Additional Collector for his approval
13	Additional Collector further verifies Indemnity Bond/Bank Guarantee status
14	Additional Collector writes any objection/s and returns file to clearing agent in case of any discrepancy
15	Additional Collector approves Indemnity Bond/Bank Guarantee, file is then marked to Assistant Collector
16	Assistant Collector signs file and marks it to Principal Appraiser
17	Principal Appraiser signs file and marks it to the Appraiser
18	Appraiser verifies amount of Bank Guarantee with Post Dated Cheque (PDC), file is returned to the clearing agent
19	Appraiser signs file after verification and submits it to Principal Appraiser
20	Principal Appraiser signs file and marks it to Data Entry Operator
21	Data Entry Operator enters particulars in AS400 to enable the deposit of Bank Guarantee in Bank Guarantee Cell

## 5.2 Hidden Costs in Import of Shipments (Lahore Dry Dock)

Sr. #	Description	SRO 818 (I)/89 PKR	SRO 554 (I)/98 PKR	Home Consumption PKR
1	Bill of Entry Manifest	100	100	100
2	Bill of Entry File	100	100	100
3	Examination	50	500	500
	Examination (Value above 100,000/-) Inspector + D.S.	1000	1000	1000
4	Examination Sepoy	100	100	100
5	Appraisalment	1000	1000	500
6	P.A. Sepoy	50	50	50
7	Counter Feed	50	500	50
8	Assessment Feed for Computer	100	100	100
9	Cash No.	150	150	150
10	Bank Expense	50	50	50
11	Constable of A.C for Signature from A.C.	50	50	N/A
12	Constable of D.C for Signature from D.C.	100	100	N/A
13	Superintendent for Bond Acceptance	100	100	N/A
14	Clerk for SRO 818 (Computer Sheet)	100	100	N/A
15	Inspector for file receive	200	200	N/A
16	Clerk for 818 File No.	50	50	N/A
17	Constable for Sample Seal	50	N/A	N/A
18	Bond Escort	N/A	500	N/A
19	Clerk for Receive of I-Bond + PDC (818), Guarantee (554)	100	100	N/A
20	Shed watchman for getting goods	300	300	300
21	Gate Inspector + D.S	300	300	800
22	Gate Computer	100	100	100
23	Clerk of LDP for Gate Pass	100	100	100
24	Inspector for final checking of entry (out of charge)	200	200	200
25	Out of charge branch sepoy	150	150	150
26	Railway clerk + Sepoy	100	100	100
<b>TOTAL</b>		<b>5200</b>	<b>6650</b>	<b>5450</b>

Source: CBR Restructuring Exercise, 2000.

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## **Institutions contacted and interviewed**

The following institutions were contacted and various personnel were interviewed with regards to the Institutions' functions, objectives, performance and were possible any MSME specific indicators:

- a. Directorate of Labour Welfare (DLW) — Punjab
- b. Directorate of Labour Welfare (DLW) — Sindh
- c. Directorate of Labour Welfare (DLW) — NWFP
- d. Directorate of Labour Welfare (DLW)– Balochistan
- e. Employees Old Age Benefit Institution (EOBI) — NWFP
- f. Employees Old Age Benefit Institution (EOBI) — Punjab
- g. Employees Social Security Institution (ESSI) — Sindh
- h. Employees Social Security Institution (ESSI) — NWFP
- i. Employees Social Security Institution (ESSI) — Balochistan
- j. Minimum Wages Board — Punjab
- k. Minimum Wages Board — Sindh
- l. Workers Welfare Board — Punjab
- m. Pakistan National Federation of Trade Unions
- n. Punjab Small Industries Corporation
- o. Small Industries Development Board
- p. Sindh Small Industrial Corporation
- q. Small Business Finance Corporation
- r. Export Promotion Bureau
- s. Kashf Foundation
- t. Customs Department
- u. Income Tax Department
- v. Sales & Excise — Punjab
- w. Sales & Excise — Balochistan
- x. Federal Bureau of Statistics

### Focus Groups

Focus groups meetings were held in various provincial cities of Pakistan in order to include the input of the MSME sector into the study:

- a. Sialkot — Punjab
- b. Gujranwala — Punjab
- c. Peshawar — NWFP
- d. Karachi — Sindh
- e. Quetta — Balochistan
- f. Lahore — Punjab (Women only)

### Policy Focus Groups

A policy focus group meeting was held in Lahore to incorporate feedback of the study from the government departments. The following departments and institutions were present in the meeting:

- a. Additional Secretary, Department of Industries, Punjab
- b. Director Monitoring & Inspection, EOBI
- c. Assistant Director, EPB
- d. Deputy Chief Manager, State Bank of Pakistan
- e. Assistant Vice President, National Bank of Pakistan
- f. Assistant Vice President, Allied Bank of Pakistan
- g. General Manager, Muslim Commercial Bank
- h. Vice President, First Women Bank
- i. Additional Commissioner, Income Tax.
- j. Director, ESSI

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7. “Home Work in Brazil: New Contractual Arrangements” (*Series on Homeworkers in the Global Economy*), Lena Lavinás, Bila Sorj, Leila Linhares, Angela Jorge, 2000
8. “Home Work in Chile: Past and Present Results of a National Survey” (*Series on Homeworkers in the Global Economy*), Helia Henríquez, Verónica Riquelme, Thelma Gálvez, Teresita Selamé, 2000
9. “Promoting Women’s Entrepreneurship Development based on Good Practice Programmes: Some Experiences from the North to the South” (*Series on Women’s Entrepreneurship Development and Gender in Enterprises — WEDGE*), Paula Kantor, 2000
10. “Case Study of Area Responses to Globalization: Foreign Direct Investment, Local Suppliers and Employment in Győr, Hungary” (*Series on Globalization, Area-based Enterprise Development and Employment*), Maarten Keune, András Toth, 2001
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