Significance of the Small and Medium Enterprises (SMEs) Sector in Pakistan and Assessment of its Employment Potential

Shahid Amjad Chaudhry*

Definitions and Sources

Definitions: In this paper it is proposed to use the definition of self-employed, small scale (2-9 employees), medium scale (10-99 employees) and large scale (100 employees and above) to discuss the issues relating to the Small and Medium Enterprise (SME) sector in Pakistan. The national pension (regulated through the Employees Old Age Benefit Institution Legislation) and health insurance (The Provincial Social Security Institutions Legislation) is applicable to institutions with 10 or more employees and provides a natural cut off point between the small scale and medium and large scale sectors. The cut off between the medium and large scale at 100 workers is also appropriate.

Sources: Major sources of data were the: (i) The Census of Establishment 1988; (ii) The Labour Force Survey 91-92; (iii) The Report of the National Manpower Commission 1991; (iv) The Employment and Management Situation in Pakistan (ILO) 1997 and (v) The Economic Survey 1997-98. A large number of other sources were also used as required and these are indicated wherever possible.

Significance of the SME Sector

The large scale sector in Pakistan has ceased to be a major engine of employment growth over the last several years and this situation is likely to continue for the foreseeable future. The large scale sector in Pakistan is and will continue to be important. It currently accounts for about 9 per cent of total employment and as much as 30 per cent of GNP. It is the dominant organisational form in the energy, telecommunications and finance sectors as well as in the provision of public (government) provided goods and services. Bank lending to the large scale sector comprise almost 60 per cent of the total bank advances. Cutting edge technology and managerial progress are intimately linked to this sector. Government denationalisation of major assets WAPDA, PTC, PIA, Nationalised Banks etc. will focus both the interest of multilateral agencies and multi-national firms further here. While all this is to be encouraged the sector is still unlikely to provide the output and

* The author is currently the Rector, Lahore School of Economics, Lahore.

employment growth that is needed by the Pakistani economy today. This output and employment growth momentum over the next decade is most likely to come from the SME Sector if its potential is appropriately tapped.

The SME Sector currently provides about 54 per cent of employment and about 50 percent of value added in Pakistan today. As mentioned above, employment in large scale enterprises is about 9 per cent of total employment and this sector contributes about 30 per cent to value added, while the self-employed sector constitutes 37 per cent of employment and has a share of about 20 per cent in value added.

Table-I.1: Pakistan Aggregate Structure of Employment 1997-98 (Estimates)

Million

	Total Mn	Self Employment Mn (%)	Small Scale Mn (%)	Medium Scale Mn (%)	Large Scale Mn (%)
Total	36.2	13.2 (37%)	16.6 (46%)	3.0 (8%)	3.4 (9%)
Urban	13.4	3.5 (26%)	4.9 (37%)	2.2 (21%)	2.9 (21%)
Rural	22.8	9.7 (42%)	11.7 (51%)	0.8 (4%)	0.5 (3 %)

Source: Estimated from *Economic Survey 1997-98, Census of Establishments 1988* and *Census of Agriculture 1990.*

Pakistan's urban areas are inhabited by about one-third of its population and provide thirty-seven percent of total employment in the country. A little more than a quarter (26 per cent) of this employed labour force is self-employed, a little more than half (53 per cent) works in the SME sector while about one-fifth (21 per cent) work for the large scale sector. Most people are engaged in trade (mostly shops) and community and social services (schools, hospitals, urban services). This is followed by employment in manufacturing, construction, transport and finance services (in decreasing order). Small scale establishments pre-dominate – providing about 37 percent of urban employment.

The rural areas, wherein the remaining two thirds of the Pakistani population live, provides employment to about 63 per cent of its employed labour force. Here the bulk (42 per cent) are self-employed, mostly in small scale agriculture and livestock production but also in trade and construction activities. The SME sector is again the largest employer (55 per cent) – but here in the rural areas almost all who work in this sector work in small establishments. The medium and large scale sector have relatively little importance in the rural areas and employ 4 and 3 per cent of the employed labour force respectively. Table I.2 presents further detailed estimates by sector of the structure of employment for both rural and urban areas.

Table-I.2: Pakistan: Structure of Employment by Sector 1997-98 (Estimates)

Million

			Total	Self Employed 1 Person	Small Scale 2-10	Med. Scale 10-100	Large Scale above 100
1	Agr. (Crop) Farming	- Rural	13.7	5.10	8.60	-	-
2	Agr. Livestock	- Rural	3.20	1.60	1.60	-	-
3	Trade	- Total	5.24	2.30	2.70	0.16	0.04
		- Urban	3.64	1.20	2.30	0.10	0.04
		- Rural	1.60	1.10	0.40	0.06	-
4	Community and Social	- Total	4.80	0.80	1.60	1.30	1.10
	Services	- Urban	3.60	0.40	1.00	1.00	1.10
		- Rural	1.20	0.40	0.60	0.30	-
5	Mining and	- Total	3.80	0.20	1.30	1.00	1.30
	Manufacturing	- Urban	2.30	0.10	0.90	0.60	0.80
		- Rural	1.50	0.10	0.40	0.40	0.50
6	Construction	- Total	2.60	2.40	0.20	-	-
		- Urban	1.60	1.40	0.20	-	-
		- Rural	1.00	1.00	-	-	-
7	Transport	- Total	1.84	0.15	0.40	0.37	0.90
		- Urban	1.61	0.09	0.30	0.32	0.88
		- Rural	0.23	0.06	-	0.05	0.02
8	Finance	- Total	0.42	-	0.18	0.16	0.06
	Services	- Urban	0.39	-	0.15	0.16	0.06
		- Rural	0.03	-	0.03	-	-
9	Other	- Total	0.06	0.60	-	-	-
		- Urban	0.30	0.30	-	-	-
		- Rural	0.30	0.30	-	-	-
	Total		36.20	13.20	16.60	3.00	3.40

Source: Estimated from *Economic Survey 1997-98, Census of Establishments 1988* and *Census of Agriculture 1990.*

The significance of the SME sector for Pakistan must therefore not only be recognised but also be made the centre piece of any employment and growth strategy. In the urban areas SMEs already provide the bulk of urban employment and are focussed in the trade, services and construction sectors where employment elasticities are quite high. In the rural areas SMEs dominate formal agriculture (with its 150 acre land reform ceiling), agricultural services (machinery repair, input and output distribution), livestock and milk production and provision of construction and community services. In both urban and rural areas SMEs are increasingly providing employment to women and encouraging their entry into the labour force. Finally, in terms of human development, SMEs in education and health are increasingly emerging as the prime agents of change.

Assessment of Employment Potential of the SME Sector

A further analysis of Pakistan's historical experience over the last years (1980-96) which examines historical sectoral growth rates and employment elasticities, clearly indicates that the agriculture crop sector and large scale manufacturing as presently constituted have lost their potential for being the engine of both output and employment growth. Output and growth potential in the agricultural and manufacturing sector is now increasingly with livestock (largely milk and poultry) production in family household units and with small scale manufacturing which, with their cumulative high growth rates of the last decade and a half, now contribute almost 45 percent of agriculture value added and one third of industrial value added. The construction sector is almost entirely self employed or small scale and despite being denied its true potential has contributed substantially to employment growth because of its labour intensity. Finally, the transport and trade sectors have shown vigorous output and employment growth and are characterised again largely by their being mainly in the SME sector. The community/social services sector (including education and health) is still largely dominated by the state sector. This historical experience is summarised in Table I.3 below.

Table-I.3: Pakistan Historical Sectoral Growth Rates and Employment Elasticites, 1980-96

		Average output Growth Rate % p.a.	Employment Elasticity	Employment Growth Rate % p.a.
1	Agriculture and Livestock - 100 % SE and SME	4.1	0.34	1.40
	(Agriculture -100 % SE and SME)	(3.2)	(-0.19)	(-0.6)
	(Livestock – 100 % SE and SME)	(5.3)	(0.51)	(2.7)
2	Manufacturing	6.9	0.18	1.24
	(Large Scale)	(5.3)	(0.02)	(0.11)
	(Small Scale)	(8.4)	(0.85)	(7.14)
3	Construction – (100 % SE and SME)	4.3	1.15	4.93
4	Transport– (50% SME)	5.7	0.48	2.76
5	Trade – (96% SE and SME)	6.2	0.61	3.79
6	Education and Social Services - (80% State owned)	6.3	0.63	4.00
	Total (average)	5.7	0.39	2.2

Source: (i) For Aggregate Sectoral Elasticities, "The Employment and Manpower Situation in Pakistan," ILO 1997.

(ii) For Agriculture, Livestock, Large Scale and Small Scale Industry Employment Elasticities estimates from ILO's "Review of the Sixth Five Year Plan," 1988.

Crop Agriculture: The entire crop agricultural sector consists either of self employed or small and medium enterprises according to our definition. About 13.7 million people (38 percent of the total employed labour force) work in 5.1 million farms in the crop agricultural sector which contributes about 14 percent to GDP. Pakistan's agricultural holdings are relatively small – 60 percent of total farm acreage or 66 percent of total cultivated area and 93 percent of farm holdings are below 25 acres. Even the larger farms are not that large. Farms 25-50 acres of which there are 240,000 average 31 acres in size (and comprise 16 percent of total farm area and 5 per cent of all farms), farms 50 to

150 acres of which there are 92,000 average 70 acres in size (comprising 12 percent of total farm area and 2 percent of all farms); while 15,300 farms above 150 acres average 311 acres in size of which on average 168 acres are cultivated and comprise 10 percent of total farm area. Given this size distribution of farms the agricultural revolution in major crop production – rice, wheat and cotton – has now run its course. Farming is almost entirely mechanised for major crops for both planting and harvesting (except for rice planting by hand because of unlevelled fields). The "glass ceiling" in agricultural major crop production has been reached. There will have to be a major shift towards high value vegetable and fruit production for which farm size and land and climatic conditions are highly suitable. This requires new technologies and institutional (including credit arrangements). Successful transition could substantially accelerate the growth rate in this sector and also reverse its current shedding of labour.

Livestock/Milk: This entire sector which contributes about 7 per cent of GDP falls in the self-employed and small scale enterprise category. The predictions of doom through social unrest, because of unemployment and low incomes in the rural areas as a result of the labour displacing effects of mechanisation which were made over the last two decades, have been averted through the remarkable growth of the livestock and particularly milk production sectors. This sector, which has been growing at almost twice the rate of the crop sector and now constitutes about 45 per cent of value added of the entire agriculture sector, has been the response of the average Pakistani villager to the labour displacing effects of mechanisation. Pakistan today has 13.6 million milking buffaloes and 4.5 million milking cows being kept in 8.5 million rural households with an average herd size of 2 buffalo/cows. Pakistan produces 20 million metric tonnes of milk - making it the 7th largest milk producer in the world (ahead of the UK which is at number 9 with 15 million metric tonnes). However Pakistan's milk yields (annually 1150 liters per animal/year) are half those of India's and are one-fifth of Europe's. This unexploited potential has immensely positive implications for income and employment growth – particularly for women who form the majority of workers in this sector. While milk production is predominant in terms of value added and employment, the poultry and meat producing sectors (particularly sheep and cattle) have also tremendous potential for output and productivity increases.

Table-I.4: Potential Agriculture Sector Output and Employment Growth Rates 2000-2010

	Actual Average Annual Output Growth Rate % p.a.	Est. Actual Employment Elasticity	Potential Average Annual Output Growth Rate % p.a.	Projected Employment Elasticity	Potential Average Annual Employment Growth Rate % p.a.
	1980-1996	1980-1986	2000-2010	2000-2010	2000-2010
1. Crop Agriculture	3.2	-0.19	4.2	0.21	0.9
(Major Crop)	(2.8)	(-0.25)	2.8	(-0.25)	-0.7
(Minor Crops Including Fruits & Veg	(4.4)	(0.25)	(6.5)	(0.25)	(1.6)
2. Livestock	5.3	0.51	6.5	(0.51)	3.3
Total	4.1	0.34	5.0	0.40	2.0

Potential of Crop Agriculture and Livestock Sectors: The agriculture sector (almost entirely crop agriculture and livestock) contributed about 22 per cent to GDP in 1996-77 and produced almost all outputs at internationally competitive levels of efficiency. Table I.4 above summarises the potential which the agriculture sector (comprising entirely self employed and small and medium scale enterprises) has for output and employment increases over the next decade. With a significant shift both towards our present day 'minor crop' including oilseeds, fruits and vegetables and also towards dairy production, the agricultural economy of Pakistan is capable of increasing its output growth rate from 4 to 5 per cent and its employment growth rate from 1.4 to 2 per cent. This will substantially stabilise the economy and also to a large extent reduce the rural to urban population drift.

Manufacturing: The manufacturing sector contributed about 15 per cent to GDP in 1996-97. The large scale manufacturing sector (100 employees and above) contributed 68 per cent of value added and 18 per cent of employment within the sector, while small enterprises contributed overwhelmingly to the remainder (self employment in the sector being virtually negligible and medium scale industry being relatively minor in terms of output and employment). Presently the large scale sector is in deep recession with almost one third of industrial capacity closed down and the firms in deep arrears to the financial system. This is not entirely surprising since a large proportion of this capacity was built behind walls of domestic protection and as these are being gradually dismantled for sensible international efficiency reasons (and under pressure from external donor agencies) they are increasingly not able to compete. An " Industrial Efficiency Study" under taken by the Governments' Planning and Development Division (completed in 1998) showed DRCs in the engineering sector of 0.90 for small, 0.70 for medium and 1.24 for large, for the textile sub-sector of 0.94 for small, 0.99 for medium and 0.71 for large, and for the chemical sub-sector of 1.16 for small, 0.94 for medium and 1.12 for large. The large scale sector in Pakistan is only efficient in agro-based products including textiles, heavy transport natural resources based products (cement) and the captive monopolistic energy sectors (energy and gas production and possibly oil refining). These large scale efficient sectors are likely to grow while the remaining large scale units will contract and continue to shed labour. ILO's Mid Term Review of the Sixth Five Year Plan in 1988 stated that the decline (to almost zero) of employment elasticity could be irreversible 'at least' over the Sixth Plan period. This state of affairs is likely to persist -perhaps as long as until 2010 - as the last of the inefficient large scale units close down. Accordingly, while large scale manufacturing may well continue to grow till 2010 at its growth rate of 5.3 per cent of the 1980-95 period, it is unlikely to provide any significant new employment over the 2000-2010 period.

An interesting feature of the Pakistan manufacturing sector is that almost the entire small scale sector is unregulated. The Pakistan Census of Manufacturing Industries (1991) which covers manufacturing establishments registered under the Factories Act 1934 reported in 1991 a total of 4792 establishments employment of 0.62 million people with a value added of Rs. 111 billion. Establishments of more than 100 employees had 0.52 million employees and contributed 87 per cent to total value added as reported in the Census. These were also 3031 establishments employing 10-99 workers employing 95 thousand workers with value added of Rs.14 billion (or 13 per cent of the total). These registered establishments are reported as large scale manufacturing in the national accounts. The unregistered ' small scale' manufacturing in the national accounts – reported separately – is estimated therein to contribute 32 per cent of the value added of the sector and now provides about 80 per cent of the total estimated employment in the sector.

While the 'un-regulated' manufacturing enterprises have grown rapidly, these are still in the nature of 'repair shops' producing spare parts for the stock of largely imported machinery vehicles and equipment in Pakistan. This sector will also continue to grow at its own pace and have the highly favourable employment elasticities (approaching 0.85) documented in the GOP's Report of the National Manpower Commission of 1991. The real potential of the manufacturing sector in Pakistan is in the medium scale sector which has the highly favourable DRCs in the agro-industry, consumer goods, textiles and engineering sub-sector (reported earlier) and which has the potential to be competitive internationally. This sector has been largely ignored in Pakistan, subject to intense regulation by a multiplicity of agencies and has also been subject to the predatory take-over of the large firms- particularly the multinationals. A recent classic example is that of Lever Brothers buying out its competitor Brooke Bond in tea and closing down its establishment with golden handshakes to workers. If the regulatory and institutional environment of this sector can be remedied and it provided appropriate credit it has the potential to grow rapidly and change the industrial structure of Pakistan.

The output and employment potential of the entire manufacturing sector is summarised in Table I.5 below for the 2000-2010 period.

Table-I.5: Potential Manufacturing Sector Output and Employment Growth Rates 2000-2010

	Actual Average Annual Output Growth Rate % p.a.	Est. Actual Employment Elasticity	Potential Average Annual Output Growth Rate % p.a.	Projected Employment Elasticity	Potential Average Annual Employment Growth Rate % p.a.
	1980-1996	1980-1986	2000-2010	2000-2010	2000-2010
Large Scale	5.3	0.02	5.3	0.02	.01
Medium Scale			8.4	0.18	1.5
Small Scale	8.4	0.85	8.4	0.85	7.1
Total	6.9	0.18	6.7	0.38	2.5

Note: Medium Scale Industries are included in Large Scale for the 1980-96 Period

Wholesale and Retail Trade Sector: The Trade Sector (including hotels and eating establishments) had a value added of Rs. 402 billion in 1997-98 (7 per cent of GDP) and employed about 5.2 million people (14.4 per cent of total employment). Within the sector 3.64 million people were employed in urban areas of which 1.2 million were self-employed, 2.3 million worked in small scale establishments (2.9 workers), 0.1 million worked in medium scale establishments (10—99 workers) and only 0.04 million worked in large scale (over 100 worker) establishments. Within the rural areas there were an estimated 1.6 million workers, of which 1.1 million were self-employed, 0.4 million worked in small scale establishments, 0.06 million worked in medium scale establishments and virtually none in large scale establishments. The sector has been growing at about 6.2 per cent per annum between 1990-96 and had an employment elasticity of 0.61. This sector has provided the bulk of employment growth in the last several decades and this sector is expected to continue its vibrant growth in the future.

At the superficial level, the sector appears to be flourishing. Both in the urban and rural areas this is the favoured sector for self employment and for small scale enterprises. There are about 2.3. million 'one-person stores' in the country equally divided between the urban and rural areas. In addition there are about 300-400 thousand small–scale establishments employing 2-9 persons mostly in the urban areas. The number of medium scale establishments are only a few thousand and large scale establishments non-existent. This rather interesting breakdown in fact shows the weaknesses presently inherent in the sector. The problem in Pakistan is the lack of medium scale establishments which have to provide the essential link between the producer and the buyer-particularly in the agricultural sector.

The Report of the National Commission on Agriculture 1998 highlighted the weaknesses in the agricultural marketing system. Defective preparation of produce, absence of organised and regulated marketing practices, and the lack of physical storage marketing facilities leads to excessive losses. This is income lost both to the producer and the trader of agricultural commodities. Substantial efficiency gains in domestic trade of agricultural products are therefore required. Finally the food preparation and hotel sector needs major improvements.

Table-I.6: Potential Trading Sector Output and Employment Growth Rates 2000-2010

	Actual Average Annual Output Growth Rate % p.a.	Est. Actual Employment Elasticity	Potential Average Annual Output Growth Rate % p.a.	Projected Employment Elasticity	Potential Average Annual Employment Growth Rate % p.a.
	1980-1996	1980-1986	2000-2010	2000-2010	2000-2010
Trade Total	6.2	0.61	8.5	0.60	5.1
Self Employed			6.5	0.61	4.0
Small Scale			6.5	0.61	4.0
Medium Scale			12.0	0.50	6.0

In order to get both productivity and employment gains, it is necessary to modernise the sector by focussing on both the small and medium scale establishments. This will require working capital, improved infrastructure and a modern regulatory environment. The potential gains in national well being (through healthy and safe products) as well as in output and employment growth are substantial and are summarised in Table I.6 above.

Education, Health and Community Services: In 1997-98 this sector employed about 4.8 million people (3.6 million in the urban areas) placing it third after agriculture and trade with regard to employment. While all major sectors of the economy are important, the key to Pakistan's growth and development in the 21st century lies in the human development sectors and particularly in education. Historically, Pakistan's record in education (and health) has been poor. The nationalisation by Mr. Bhutto in 1973 of all private sector educational (and health) institutions is now acknowledged to have destroyed the sector. As public sector educational (and health) institutions deteriorated, private sector SMEs in the form of private schools and colleges and private hospitals have emerged to fill the gap. These SMEs are harassed through over-regulation and seldom encouraged. Their true potential has therefore not been realised.

Education: Pakistan with its literacy rate of 46 per cent (1998 census) has very poor educational indicators for a country of 130 million people. By the last count (1996-97) Pakistan had only about 175,000 schools (150,000 primary), a thousand colleges and 25 universities in the education sector employing about 700,000 teachers (215,000 female). There are only about 22 million students in schools (9 million girls) and about 1.1 million in colleges and universities (0.4 million girls). About 90 per cent of educational establishments are in the public sector. However, private sector educational institutions are rapidly being established. A recent (1997) survey by the Punjab Government indicated that 60 per cent of children in primary schools in Lahore go to private schools and 80 per cent of these pay less than Rs.100 per month.

While the Government and the international agencies (particularly the World Bank and ADP) are pushing public sector education through the vehicle of the SAP (the Social Action Programme) aiming to increase public sector expenditure from 2 to 3 per cent of GDP it is increasingly clear that education in the urban areas cannot be provided of the required magnitude and quality solely by the public sector. The enrolment ratio needs to be increased by 50 per cent for primary education, doubled for secondary education and quadrupled in the colleges and universities over the next decade. This will require another 780,000 teachers (half of them female) and implies a growth rate of about 7 per cent per annum. About three quarters of this growth should be in the urban areas and should be provided by private sector SMEs (Schools, Colleges and Universities). However, this will require a sea-change in thinking by the public sector oriented educational, administrative and political establishment where the current attitude towards private educational institutions is to "fine them, control their fees and drive them from the cities" through draconian (and often arbitrary) regulations.

Health: Pakistan's health sector is miniscule, with (in 1996) about 900 hospitals with 73,000 beds, 5000 dispensaries and rural health centres with 3000 beds, and 74,000 doctors, 3000 dentists, 21,000 mid-wives and 23,000 nurses. Ninety five percent of health establishments are in the public sector. Pakistan's health sector indicators (like its education indicators) are poor and the country needs at a minimum to double its health establishment over the next decade (which implies a growth rate of 7 per cent per annum) almost entirely from the private sector. The health establishment is more permissive to the growth of the private sector in health- perhaps because the entire health sector establishment including the leading doctors work in public sector hospitals during the mornings and also have their private hospitals and clinics which they operate in the afternoon and evenings. Overall, however, the private sector in health needs to be further encouraged. The growing private sector health institutions will be almost entirely SMEs.

Community Services: This sector employs about 3 million people and provides community services. The majority are government employees engaged in public administration. There are about two million public sector employees in public administration. Another half a million work in the provision of public community services including education (but excluding teaching staff), health (excluding doctors and nurses) and recreation. The remaining half a million are in private service and provide personal services divided almost equally between repair services and personal services (including as domestics). Growth in municipal / city employment in both the public and private sectors is likely to maintain historical community urban sector employment growth rates at about 6 per cent per annum. However, within this government, employment will decline while increasingly private sector SME establishments will be used for contracting out tasks. Employment in health and education related community services has the potential to grow at about 7 per annum as noted earlier.

Table-I.7: Potential Education, Health and Community Services Output and Employment Growth Rates 2000-2010

	Actual Average Annual Output Growth Rate % p.a.	Est. Actual Employment Elasticity	Potential Average Annual Output Growth Rate % p.a.	Projected Employment Elasticity	Potential Average Annual Employment Growth Rate % p.a.
	1980-1996	1980-1986	2000-2010	2000-2010	2000-2010
Total Community Services	6.3	0.63	11.00	0.63	6.93
Public Education			6.00	0.63	3.78
Private Education (SME)			12.00	0.63	7.56
Public Health			6.00	0.63	3.78
Private Health (SME)			8.00	0.63	5.04
Other Community Services					
Public			6.00	0.63	3.78
Private (SME)			1.50	0.63	6.61

Table I.7 sums up the output and employment potential of the education, health and community services sector. This sector has the unique potential of doubling its present employment in ten years i.e. from 4.8 million in 1997-98 to 10 million in 2010. The demand is there, the potential to provide these services from the private SME sector is there. The only feature lacking is supporting government policy.

The Construction Sector: In 1996-97 the construction sector contributed about Rs.83 billion to value added (4 per cent of GDP) and employed 2.6 million people (1.6 million in the urban areas). Almost all construction workers are definitionally self employed – hiring out their labour on a one-to-one basis or through contractors (which is the norm in the urban areas and turns the labour force technically into an SME). The sector is highly labour intensive – its employment elasticity was estimated at 1.15 in the 1980-95 period.

The sector has substantial potential – given the shortage of housing in Pakistan. However this potential has been poorly realised —as shown by its average 4.3 per cent growth rate in the 1980-96 period. The sector is constrained by poor housing policies including the absence of public built housing and/or financing for private housing. In addition, the recent privatisation of the cement industry has created an industrial cartel which has doubled prices over the last year and restricted output to 50 per cent of capacity. If these constraints can be removed the sector has the potential to grow at least at the projected rate of the National Economy (about 6 per cent per annum) and with its employment elasticity of 1.15 double its employment levels over the next decade (from 2.6 million in 1996-97 to 6 million in 2010).

The Transport and Communication Sector: This sector contributes about Rs.221 billion to value added (10 per cent of GDP) and employs about 1.8 million people. This sector has an employment elasticity of 0.48 largely due to the road transport sector which is relatively labour intensive compared to the air and (almost negligible) sea transport sectors. The telecommunication sector which contributes almost one-third to value added of the sector also provides very little aggregate employment. The road transport sector is almost entirely SMEs (about half of total employment). The air, sea, telecommunication, radio and TV sectors are entirely large scale and are almost all government monopolies – these provide the other half of the employment of the sector.

While all these sub-sectors have substantial output potential, only the road transport sector seems to have major employment potential. The government monopolies are inefficient and are in the process of being privatised. They will therefore be likely to shed labour or at least not have substantial employment growth over the next decade. Substantial employment potential exists in the road transport sector and with current major road building and automobile assembly programmes under way, the sector will likely grow at seven or eight percent per annum over the next decade. Overall output for the sector has the potential to double and employment to grow by 70 percent over current levels.

Conclusions: The SME sector in Pakistan has the potential to grow very rapidly and with its favourable employment elasticities can also provide substantial additional employment for Pakistanis. While all sectors have this potential (except air services, telecommunications and finance) – the analysis undertaken above indicates that the education sector offers perhaps the single largest potential for employment generation. A comparison of employment possibilities in 2010 (Table I.8 below) indicates that a strategy drawn by using the potential of private SMEs in all sectors and particularly education could create 7.3 million additional jobs compared to the continuation of present policies. Even with the continuation of present polices the bulk of new employment generation will be by SMEs.

Table-I.8: Summary Potential Sector Employment 1997-2010 alternative Scenarios.

Millions

	Employment 1997-98	Employment Scenario # 1 2010	Employment Scenario # 2 2010
Agriculture	16.9	20.0	21.4
Manufacturing	3.8	4.4	5.1
Trade	5.2	8.1	9.4
Education & Social Services	4.8	7.7	10.7
Construction	2.6	4.6	5.2
Transport	1.8	2.5	2.7
Others (in Finance)	1.0	1.6	1.7
Total	36.1	48.9	56.2

Note: Employment Scenario #1 uses historical 1980-95 average output growth rates and employment elasticities. Employment Scenario # 2 uses potential average output growth rates and employment elasticities developed in this chapter.

II. Assessment of Existing SME Related Policies Programmes in Pakistan

SMEs provide the bulk of economic activity and employment all over the world including in the developed countries. Italy with a per capita income higher than that of the United Kingdom is particularly known for an extremely large (more than 60 per cent of the economy) and dynamic SME sector which dominates the world in production of quality products including machinery, textiles and clothing. The lessons from the world experience are fairly well established. A healthy and prosperous SME sector depends upon: (i) A stable macro economic environment under a free trade regime; (ii) A workable legal and judicial system; (iii) Fair regulatory policies which encourage competition and protect SMEs from the predatory policies of both private monopolies and state power; (iv) A well functioning and competitive financial sector to provide Banking Services and Finance to SMEs; (v) A Business Development Services Infrastructure to provide both advocacy and policy formulation so that SMEs have increasing access to information, technology, finance, markets and training; and (vi) Sector-specific SME policies. Pakistan's Policy Frame-work towards SMEs needs to be reviewed in this analytical frame-work.

Stable Macro-Economic Policies and a Freer Trade Regime

Pakistan's macro-economic management over the last few decades has been poor and the country was able to sustain a sufficiently high level of economic activity over the last decade mainly through heavy domestic borrowing, large external aid inflows, private foreign investment particularly in the energy sector and huge and increasing foreign exchange balances held in Pakistan largely by Pakistanis resident overseas. The Pakistan economy was in an inherently unstable situation throughout the 1990-97 period and it was only a matter of time before the bubble would burst. This was triggered by the Atomic Tests undertaken by Pakistan on May 28,1998 as a response to the Indian Atomic Tests on May 11,1998. The western countries and IFIs suspended their assistance and private foreign investment, and Pakistan "froze" the non-existent foreign currency deposits (FCAs) which had long since been used up, as shown by the fact that its reserves were less than $1 billion on May 28,1998 compared to the FCAs of $ 11.5 billion. Subsequently, by wise economic management domestically and by support from a reluctant western world which did not want to see an economically collapsed Pakistan with atomic weapons which may proliferate, the country revived in 1999 an IMF Extended Fund Facility which led to debt relief by the western creditors for the two year period 1999-2000. The Government of Pakistan IMF/World Bank Programmes extended through June 2000 with programmes targets been set to June 2002. Since the next four years macro-economic management of the Pakistan economy will be in an "IMF/World Bank Agreed Mode" it is useful to consider the Pakistan/IMF programme as the Medium Term Macro-economic Programme of the Government of Pakistan.

The Pakistan – IMF Macro-economic Programme 1999-2002: The GOP Policy Frame-Work Paper (PFP) agreed with the IMF in 1999 had the following four major objectives: (i) Recovery of real annual GDP to 5-6 percent (up from 3.5 per cent 1998-99); (ii) Reduction in inflation to about 6 per cent (down from about 18 per cent in 1997-98 and about 9 per cent in 1998-99); (iii) Reduction in the current account deficit (excluding official transfers) to less than 5 per cent GDP; and (iv) Stabilisation of the public sector Debt to GDP Ratio. In order to achieve these objectives the following major policy actions have been agreed upon: (i) Reduction in the fiscal deficit from 5.4 per cent of GDP in FY 99 to 3.3 per cent in FY 2000; (ii) Retirement of domestic debt up to the rescheduled amount originally due to official creditors (about $ 5 billion due in 1999-2000); (iii) Unification of the exchange rate by July 1,1999 to a market determined rate (currently there is a " composite rate" which is 95 per cent market determined and 5 per cent official), (iv) Removal of all quantitative restrictions on exports and imports by July 1,1999; (v) Reducing the dispersion of Tariff Rates to 0-35 per cent by March 31,1999 (already done); (vi) Accelerating the privatisation process in all sectors including the sale of all major nationalised banks in 1999; and (vii) Restoring foreign investor confidence by reaching an agreement with foreign Independent Power Projects (on a per unit 6.2 cents electricity charge or an alternate 3 cents capacity charge). The fiscal deficit target was to be met through: (i) Increase of the General Sales Tax on goods (except agricultural inputs) to 15 per cent (already done by Jan 1,1999) and its extension to services, petroleum products, electricity and agricultural inputs by FY 99-00; (ii) Increasing coverage of the General Sales Tax to small retailers by FY 99-00; (iii) Revenues from Tax on Agriculture to be increased to 0.3 per cent of GDP in the medium –term with assistance from the World Bank starting by March 1999; (iv) Increasing power tariffs to meet revenue requirements of WAPDA and removing cross subsidies particularly to agriculture (an average increase of 9.5 per cent in the overall power tariff implemented in April 1999 including a 70 per cent increase of tariff of agricultural tube-wells – further increases as required); (vi) Adjusting petroleum prices to retain the present rate of petroleum development surcharge on petroleum products at Rs. 15.65 per litre for motor spirits; Rs.4.37 for high speed diesel and Rs.1.5 per litre for fuel oil to give revenues equal to about Rs.80 billion or 3 per cent of GDP; and (vii) Cutting back public expenditure as required throughout the Programme Period to meet the deficit targets (the Public Sector Development Programme of the Federal Government has been slashed in 1998-99 to less than 3 per cent of GDP to meet this target). Other major PFP agreements state that: (i) The existing hiring freeze at the Federal level will be maintained; (ii) Administrative reforms will be undertaken; (iii) New public sector projects will be carefully scrutinised; (iv) In social policies emphasis will be on primary education, basic health care, population welfare (planning), water supply and sanitation; and (v) In the transport sector public sector allocation for rehabilitation and selective improvement of highest priority road network will be enhanced.

Suggestions to Strengthen Pakistan's Macro-Economic and Public Policy Management: The 1999-2000 Pakistan-IMF Programme formed an excellent starting point to provide macro-economic stability and a freer trade regime for the economy over the next several years. This is of vital importance to the growth of the SME sector which needs a stable macro-economic environment, continuity of macro-economic policies and free trade to prosper. However, there are several areas where the macro-economic and public policy framework needs to be additionally strengthened to meet the free competition requirements of the SME sector. First, with regard to privatisation policies no natural monopolies should be privatised (for example railway ground infrastructure should not be privatised while railway goods and passenger traffic wagon and trains infrastructure can be privatised). Second, with regard to private investment irreplaceable land sites should not be eligible for permanent private ownership (BOT rather BOO) for roads, airports, harbours and electric power dams. Third, the Government should maintain a permanent minority share (a minimum of 20 per cent) in all major privatised companies as a major source of future revenue. Fourth, enhance the quality of high level manpower in Government by aggressively recruiting qualified people for government service and retraining presently underqualified public servants. Fifth, encourage the rapid growth of education at all levels (not just the primary level) particularly by upgrading and more intensively using existing public education facilities and by relying increasingly on private education through supportive public policies.

Workable Legal and Judicial System.

Pakistan is very fortunate in having a very honourable and extensive judicial system with a long historical tradition. However, the major elements of civil laws and procedures still continue from the pre-independence period. This, coupled with inadequate funding for the judicial system and antiquated court and case management procedures has meant that civil courts are choked with litigation and recourse to civil action (particularly against two civilian adverseries) rarely reaches judicial closure. As a result financial institutions are reluctant to lend only against the limited liability of the companies and instead insist (when they lend at all) on having the borrower mortgage other assets (including personal assets) to secure lending. As a result, all banking/finance civil suits have been reduced to mortgage suits. The recent Banking Act of 1997 created Banking Courts with accelerated procedures. However, these courts also function effectively only as mortgage courts. The overall result of all the above is that the legal and judicial system needs to be further strengthened in order to allow SMEs to function effectively.

Present Government and Judicial Initiatives to Strengthen the Legal System:. The Government and the Judiciary has now been increasingly sensitised to making the system work more effectively. The push towards judicial reform is presently largely aimed at the criminal justice side due to recent terrorist and other related threats. However, the Government and the Judiciary has also been working with the Asian Development Bank (ADB) to put into place a medium term programme to strengthen court and case management systems throughout Pakistan and to increase the efficiency of civil litigation including through review of the Civil Procedural Law. This GOP/ADB Judicial Sector Programme is expected to be in place by the end of 2000.

Suggested Additional Policies to Strengthen the Legal System: The SME related requirements for the judicial system should also be integrated into all future proposals for judicial and legal reform. In addition to accelerating civil litigation dispute resolution between civilian parties, a particular requirement is to protect the small and medium enterprises from the often predatory and arbitrary regulatory actions by the state. The United States "Small Business Regulatory Enforcement Fairness Act of 1996" made the following amendment to the United States Code: "If, in a civil action brought by the United States....the demand by the United States is substantially in excess of the judgement obtained by the United States .... The court shall award to the party the fees and other expenses related to defending against the unreasonable demand". A similar proviso is recommended under the appropriate Civil Laws in Pakistan.

Regulatory Policies

Regulatory Policies affecting SMEs fall under two broad categories: (i) Regulatory Policies which encourage Free Competition and Free Trade; and (ii) Regulatory Policies which regulate the functioning of SMEs by State authorities (including Local Bodies) and which need to be fair and not anti-SME.

Present Government Policies Concerning Free Trade and Competition: With regard to the first, the Pakistan–IMF agreement on lifting all quantitative restrictions on exports and imports by July 1999 will help achieve the freer trade objective. Arbitrary increases in tariffs and export duties through "SROs" issued by the Central Board of Revenue were intended to be abolished under the 1999-2000 IMF agreement. However, the quick Government decision to impose a 20 per cent regulatory duty on sugar by the Economic Committee of the Cabinet rather than the National Tariff Commission after maximum import duties on all commodities were lowered to 35 per cent (on March 31,1999) shows that the SRO abolishment agreement may not be entirely effective. Serious additional issues relate to monopoly control and competition. Here both the Monopoly Control Authority (created in the 1970's) and the National Electric Power Regulatory Authority (created last year) seem completely ineffective. The Monopoly Control Authority gave a judgement in December 1998 on cement prices which was completely ignored by the Cement Manufacturers (and contradicted by an arbitrary decision at a meeting chaired by the Minister of Finance). The National Electric Power Authority after going through weeks of hearings on a WAPDA petition to revise tariffs found itself with a revised petition on March 30,1999 drafted by the World Bank (and WAPDA) and was forced to announce acceptance of the revised petition the same night. Both these incidents show that monopoly control in Pakistan is completely ineffective.

Another major barrier to domestic trade and competition were the import and export taxes varying from 1.5 to 6.5 percent imposed by the local urban bodies and local rural bodies respectively throughout Pakistan. These were payable through all the jurisdictions which goods pass through and while subject to refund at intermediate (passing through) jurisdictions, in fact are de-facto not refundable since all their taxes are auctioned to contractors. These domestic trade taxes constituted a huge barrier to the development of SMEs in Pakistan. The 1999-2000 IMF agreement stipulated that these taxes be abolished once the General Sales Tax is extended to services with the proceeds passed on to the Provinces and this has been done with effect from July 1, 1999.

Suggested Additional Policies to Improve Free Trade and Competition: In order to remove arbitrary government discretion on trade policy and tariff changes, these should be implemented through Finance Acts passed by the National Assembly. Similarly, to reduce the influence of monopolists, the Government Agencies and the International Finance Institutions such as the World Bank and ADB or the Regulatory Agencies should be placed under the Supreme Court.

Present Government Regulatory Policies Affecting SMEs Directly: There are a large range of outmoded regulations imposed by the State, Provincial Governments, Local Bodies and Public Sector Utilities which affect the day to day functioning of the SMEs. These range from out-dated Local Body and State zoning regulations (which particularly adversely affect private schools) to a multiplicity of utility agency (water supply, electricity etc) regulations.

Most of these regulations are obscure and arbitrary. They exist largely because of the fact that most legislation in Pakistan has an enabling clause which allow "regulations to be made by the Government/Authority to give effect to the purposes of this Act". These subsequent regulations are never scrutinised at high levels and largely reflect the whims of administrative secretaries and politicians and in the absence of a "sun-set clause", survive for generations buried away in cup-boards to be used to harass SMEs at unexpected intervals. While there is no deliberate policy to harass SMEs but only to "protect the public interest", the adverse effects of these policies on SMEs are often not anticipated correctly.

Suggested Additional Policies to Improve the Regulatory Environment Affecting SMEs: Several countries have faced and overcome the problem of an existing regulatory environment which is detrimental to the fair and efficient functioning of SMEs. A land-mark Act in this regard is the U.S. Small Business Regulatory Enforcement Act of 1996 referred to earlier. This Act has the following objectives: (i) Create a more co-operative regulatory environment among Government Agencies and Small Businesses that is less punitive and more solution-oriented; (ii) Make Federal regulators more accountable for their enforcement actions by providing small entities with a meaningful opportunity for the redress of excessive enforcement activities; (iii) Provide for judicial review of regulatory actions; and (iv) Encourage effective participation of small business in the Federal Regulatory Process. The Act provides for Oversight of Federal Regulatory Enforcement by establishing in each state a Regional Small Business Regulatory Fairness Board comprising five members who are owners or officers of small businesses. There Boards report substantiated incidents of excessive regulatory action against small businesses to a Regional Small Business Ombudsman who works with agencies to remove genuine problems and reports his findings to the Congress and the Federal Government.

It is recommended that similar legislation be enacted in Pakistan to improve the regulatory environment affecting SMEs.

Banking Services and Finance Policies

A well functioning and competitive financial sector is a pre-requisite for SME development and growth. Pakistan is again fortunate in having a relatively modern and efficient Banking and Financial Services sector (including Leasing Companies and Islamic Financial Institutions). However, inappropriate and politically influenced lending by public sector banks and the depressed economic conditions over the last few years (including in the critical textiles sector) has meant that the "non-performing loans" portfolio of public sector banks is currently about 30 per cent of their assets and of private banks (mainly foreign banks) about 17 per cent of their assets. This coupled with the legal problems of debt collection and financial restructuring referred to earlier has meant that banks need to add a 5-7 per cent mark-up on normal interest rates to maintain operations and provision for losses. As a result interest rates for SME borrowers currently range between 17-20 per cent while for big borrowers they are about 14-16 per cent. However even at these high interest rates banks are extremely reluctant to lend to small and medium scale enterprises. As Table II.1 indicates, loans to Small Businesses comprise only about 10 per cent of total private sector credit by the scheduled banks while the Government Self Employment Scheme received only 2 per cent of total credit. The remaining 88 per cent of all credit in the economy went to larger businesses (of which 60 per cent went to 8,589 large companies each borrowing in excess of Rs.10 million).

Table-II.1: Private Sector Credit by Scheduled Banks, 1998

Rs. Billions

		Stock				Flow	
		November 1998		June 1998		July- November 1998	
		Total	Percent	Total	Percent	Total	Percent
	Total	598.7	100%	573.1	100%	25.7	100%
1.	Export Financing	77.7	13 %	70.8	12 %	6.9	27 %
2.	Government Self Employment Scheme	10.1	2 %	10.9	2 %	-0.8	-3 %
	(Unemployed Persons)	(2.1)	(0.4 %)	(1.5)	(0.3 %)	(0.6)	(2 %)
	(Public Transport)	(8.0)	(1.6 %)	(9.4)	(2 %)	(-1.4)	(-5%)
3.	Small Loans	60.8	10 %	57.6	10 %	3.2	12 %
	(Agriculture)	(29.2)	(5 %)	(25.2)	(4 %)	(4.0)	(16 %)
	(Business)	(11.1)	(2 %)	(10.3)	(2 %)	(0.8)	(3 %)
	(Industry)	(20.6)	(3 %)	(22.1)	(4 %)	(-1.5)	(-7 %)
4.	Agriculture (Large Scale)	59.7	10 %	59.1	10 %	0.6	2 %
5.	Manufacturing (Large Scale)	230.2	38 %	221.2	39 %	9.0	35 %
6.	Trade (Large Scale)	27.4	5 %	27.2	5 %	0.2	1 %
7.	Import Financing	11.6	2 %	13.2	2 %	-1.6	(-6 %)
8.	Investment (Long Term)	23.6	4 %	17.0	3 %	6.6	26 %
9.	Others	97.6	16 %	96.0	17 %	1.6	6 %

Source: State Bank of Pakistan

Present Government and Banking and Finance Service Policies for SMEs: Government policies have been focussing on: (i) Bringing down interest rates; (ii) Increasing small loans to the agricultural sector; (iii) Increasing disbursements under the self employment scheme (being personally promoted by the former Prime Minister by receiving half an hour of public phone calls every week; and (iv) Creation of the Small and Medium Enterprise Development Authority (SMEDA) to act as an "Advocacy Mechanism" to enhance commercial bank lending to SMEs. A major step to reduce interest rates has been taken by the Government retiring Rs.43 billion of domestic debt in the period July'98/March'99 (these being the savings on the external debt rescheduling) and by the consequent ability of the State Bank to cut its short-term liquidity requirement related interest rates to Banks including the three day REPO rate from 15.5 per cent to 14 per cent in April 1999. This is expected to lead to a similar cut in bank lending rates (to about 19 per cent for SMEs) immediately and this downward trend should be maintainable if the fiscal deficit continues to be curtailed and further debt rescheduling relief is applied to the reduction of Government debt. The increased small loans to the agriculture sector comprise essentially increased tractor loans as a result of a Rs. 1 lakh (or 30 per cent of cost) subsidy on tractors provided to manufacturers of agricultural tractors during 1998-99. The disbursements under the self-employment scheme have been slow but increasing largely because of pressures exerted by the former Prime-Minister himself. Finally, SMEDA has been established in Autumn 1998 (discussed in the next section) with a view to providing an "advocacy mechanism" for SME's including to obtain bank financing. SMEDA's original effort in this regard has been resisted by the commercial banks as inefficient directed credit. The commercial banks have so far been successful in resisting directed credit as was confirmed by the former Prime-Minister himself in March 1999 when he officially announced that SMEDA will act as facilitator and not extend/sanction loans for any project. However, it is expected that SMEDA's efforts will have a positive effect on commercial bank lending for SMEs.

Suggested Finance Sector Policies for SMEs: One major policy instrument for freeing bank credit for SMEs and also to enhance the working of credit markets is to encourage large scale enterprises (with sales above Rs. 1 billion per annum) to go to the market with their own 'term-finance certificates' and rely a little less on bank credit. This could be accomplished by allowing them only a 95 per cent tax credit offset on interest payments to Banks as against a 100 per cent tax credit on interest payments on their own term-finance certificates to be placed in the open market. The interest rate credit for commercial bank borrowing applicable to these large companies could be reduced further every year depending on the success of the initial reduction and the ability of these largest companies – both public and private – to raise a small proportion of their credit requirements in the open market. A second policy instrument would be to allow banks to take up equity in SMEs and other enterprises (a legal option which is available to all banks operating in Europe). Finally, a third policy instrument (already available) is to encourage the growth of Leasing Companies to lease to SMEs which will compensate for the reluctance of Banks to extend credit to SMEs because of the faulty legal environment concerning collection and administration of bad debts (discussed earlier). Venture capital is still unknown in Pakistan but has proved to be an important source of capital in developed counties and emerging markets.

Business Development Services

SMEs need Business Development Services in order to function in any economy. Agencies (or an agency) is needed for SME advocacy purposes in Government and political fora, to increase access to information and counseling of SMEs, and to obtain access to technology, to markets, to finance and training for SMEs. They (or it) also serves as a coordinating and strengthening point for SME Business Associations.

Present Government Policies Concerning Business Development Services for SMEs: As mentioned earlier, the previous Government created the Small and Medium Enterprise Development Authority (SMEDA) in the fall of 1998 to focus as the Key Government Agency for promoting SMEs. SMEDA is still in the process of defining its turf (as was mentioned in the earlier discussion on the battle for 'directed credit' for SMEs which SMEDA lost). However, it is headed by a dynamic chairman and has highly qualified staff which has done detailed analysis of various sectors. Its analysis of the Fisheries Export Sector presented to the Government and the Commercial Bank Sector and the consequent restructuring of the Sea-Food industry currently under way (including through loans for fisherman and by legislation to correct the policy environment) is a good example of what SMEDA is capable of doing. Major new sectoral initiatives include jewelry, surgical instruments, agricultural products, electronic goods assembly, light machinery and the transport sector.

Suggestions Concerning Business Development Services for SMEs: SMEDA's role as an 'advocacy agency' including detailed study of industries and products relating to finance, markets, training, information and counseling is well under way. What now needs to be developed further is its policy formulation abilities particularly with regard to balancing the regulatory requirements of the state against the de-regulation requirements of the SMEs. This will require adding to its staff a core group of economists and will result in a substantially strengthened SMEDA.

Sector Specific SME Policies

The Government needs to develop sector specific SME policies, in part through SMEDA and in part through the Business Associations in the respective SME Sectors. The only sector specific SME policy that has been developed so far is for Housing and this was formulated by a Committee of Developers appointed by the former Prime Minister Mr. Nawaz Sharif. Its findings were made public in March 1998 and approved by the former Prime Minister. A summary of the proposals in Mr. Nawaz Sharif's Housing Policy is quoted below as an example of the excellent work which is possible to do to promote the SME sector in Pakistan and which must be done as a matter of priority for all SME sectors in the coming months.

Government of Pakistan Proposed Housing Policy 1999: Former Prime Minister Nawaz Sharif approved in March 1999 a number of measures for the construction of 500,000 housing units all over the country under his programme for economic revival (housing sector). These proposed measures (many of which have been abandoned/postponed after the fall of the Nawaz Sharif government) had the following major elements: (i) Enhance the loan portfolio of the House Building Finance Corporation from the present Rs 2 billion to Rs 7 billion. Also the mark-up on loans up to Rs 300,000 be considered for reduction to 10 per cent for low income group; (ii) All commercial banks to advance loans for houses and housing projects by earmarking a substantial percentage of their loan portfolio, like other industrial and commercial projects; (iii) Banks be allowed to give mortgage loans and float long term bonds at market rates; (iv) Re-finance window be opened at the State Bank of Pakistan (SBP) for long-term funds from multilateral agencies; (v) Institutions maintaining insurance funds, provident funds etc., be allowed to invest a substantial part of their portfolio in the housing sector; (vi) The foreclosure laws would be examined to see if there was a need for modification to ensure the effective recovery of advances from the defaulters within 90 days. As a result, banks would have legal powers to repossess a house, if the borrower defaults;(vii) Development of unified, transparent and market value oriented land acquisition laws and procedures for the entire country; (viii) The Federal Government including Evacuee Trust Property Board, Ministry of Railways, and other autonomous bodies and corporations would identify land with them to the PM's committee on economic revival; (ix) Presently, duties/registration fees are exceptionally high and are in the range of 15 per cent to 21 per cent. Aggregate total charge be considered to be around 5 per cent; (x) Housing loan installments to individuals were to be treated as expenses in tax return;

(xi) Collection of levies such as EOBI, education cess, social security, professional tax etc. would be through "one window" operation; (xii) Property Tax should be substantially reduced; (xiii) Wealth Tax not be charged on housing; (xiv) Developers/investors, local and international, would be treated at par; (xv) Development of master/structural plans, including base maps on GIS, were to be made a mandatory requirement for all urban and rural areas, at all levels of the Government. Updating of master/structural plans on a regular basis (every 5 years) may also have been made a mandatory requirement; (xvi) Development of unified building and zoning regulations of all the urban centres were to be made mandatory; (xvii) Development of computerised land information system would be made a mandatory requirement, for all urban and rural areas, to ensure correct and updated information on all land in urban and rural areas; (xviii) It should be made mandatory for the utility agencies to provide trunk infrastructure for approved housing schemes, satellite towns, and other suburban development; (xix) Charge of non-utilisation fee would be made only after notified handing over of the scheme by the development authority to the municipality; (xx) Housing be given the status of industry and be made entitled to privileges given to other recognised industries. The housing industry would be entitled to all fiscal incentives/special treatment and other benefits, as envisaged in the investment policy announced by the government.

III. Education, Labour Laws and Social Security – Reinforcing the SME Agenda through Focus on Vulnerable Groups: Children, Women, Unorganised Labour and the Elderly

The SME Agenda for Pakistan has a vital social and economic dimension which needs to be examined through another perspective by focus on vulnerable groups – children, women, unorganised labour and the elderly. Poor school enrollment ratios, child labour, employment discrimination against women, the exploitation of unorganised labour and the lack of care for the elderly are issues of vital national concern. What is not being adequately recognised is that these issues are an integral part of the SME agenda – being both part of the initial problem and the ultimate solution.

Poor School Enrollment Ratios, Child Labour and Employment Discrimination Against Women

School Enrollment Ratios: In Pakistan school enrollment ratios are low compared to any country in South Asia (e.g. the Gross Enrollment Ratio GER- for primary schooling age 5-9 is 76 per cent for Pakistan compared to 98 per cent for India for 1997-98). Gender discrimination (against females) is pronounced and becomes progressively worse at each higher stage in the school system. GERs are particularly poor for the age group 10-14 years (the middle and secondary school levels) with only 5.5 million children out of 17 million enrolled – a GER of 32 per cent for all children in this age group (the GER for females is about 23 per cent)

Table-III.1: Pakistan School Age Population and Enrolment Rates 1998

Class	Age Group	Total Number (Mn)	Enrollmen t (Mn)	Out of School (Mn)	Gross Enrollmen t Ratio	G.Female Enrollmen t Ratio
Primary	**5-9 Years**	20.5	15.5	5.0	76 %	64 %
Middle	10-12 Years	9.5	3.8	5.7	40 %	30 %
Secondary	13-14 Years	7.5	1.7	5.8	23 %	16 %
	Total	37.5	21.0	16.5	56 %	46 %

Source: For Age structure of Population from Akhtar Husan Khan "1998 Census: The Results and Implications". For School Enrollment "G.O.P Fifty Years of Pakistan in Statistics".

Child Labour: There are varying estimates for working children in the 10-14 year age group but it is conservatively estimated that at least 20 per cent of these children (about 3.4 million in 1998) work as child labour. This constitutes about 9 per cent of the country's labour force. Most of these children are employed in small scale enterprises not regulated under the Factories Act and in the informal sector. As has been clearly documented in several studies their working conditions are poor, their wages pitiful, and they are subjected to severe health hazards and sexual abuse and violence (Akmal Husain, *Lahore Journal of Economics*, 1997). In agriculture, children are involved in pesticide and fertilizer applications, rice transplantation, fodder cutting, weeding and harvesting. In urban and semi-urban areas they are engaged in the services, small scale manufacturing and construction related sectors where they often work 54-72 hours per week at an average wage of about Rs.320 (US $ 6) per month which is about one –sixth of the average minimum wage.

Current Government Policies in the School Education Sector: In the school education sector the entire public education programme is driven by the Social Action Programme of the World Bank (co-financed by other donor agencies). A stringent set of conditionalities are in place to try to gradually increase public sector expenditure on school education (from 2 to 3 per cent of GDP) in order to expand coverage and to improve the functioning and curriculum of government schools. However, the extremely constrained financial situation has meant that expansion of the system's coverage is painfully slow, and efforts being made to upgrade teaching staff and curricula are being foiled by a variety of political pressures and legal actions by the public sector teachers (the latest being a "stay order" being obtained by Punjab's 20,000 English Language School Teachers from being asked to take a proficiency test in English).

Proposed Polices for the School Education Sector: While public sector schooling should be supported through the SAP, donor pre-occupation with the SAP Programme and the vested interests of the public education bureaucracy has resulted in neglect (and in fact persecution) of the private educational sector. The former Sindh Governor publicly pointed out on April 20,1999 that 80 per cent of Sindh's students appearing for the Matriculation Examination come from private schools. This is true for all Pakistan. Beyond the primary level, the bulk of education and particularly quality education is now being provided by the private sector through SME sized schools. Surveys indicate that private schools provide comparable education at half the cost of the public schools with better qualified staff. Yet these schools are treated as "profit making institutions" and subjected to excessive regulation and taxes. Serious problems are created by Pakistan's archaic zoning regulations as a result of which every one of all the tens of thousands of private schools of Pakistan are "illegal" – not having "commercialised" their premises. This "commercialisation" involves a very large cost – as if they were setting up a commercial shopping centre - which these Schools cannot afford to do. Similarly all utilities are supplied to them at "commercial rates" which are twice the industrial (and domestic) rates. Perhaps most damaging is the apathy and down-right hostility to the private school system shown by the politicians and the bureaucrats which does not allow a rationalisation of the system.

Primary education (through class V or age 10) has been compulsory in the Punjab and NWFP since 1993. It is now proposed that compulsory middle school education should be legislated from September 1999 and through high school (class X or age 14) from September 2005 recognising the lags inherent in implementation. In order to meet these school education and higher education sector student enrollment and related teacher training and employment targets for the period 2000-2010 through expansion of the private educational system as proposed in the first part of this report, it is suggested that: (i) The Private Education Sector be treated as an "industry" for the purposes of all government policies including tax and credit policies and for the pricing of all public utilities; (ii) the Private Education sector be completely de-regulated and there be no control (pre-approval) of fees, other charges etc; and (iii) That Zoning Laws all over Pakistan be changed by a uniform Federal Law which will set reasonable zoning standards to encourage private schools in all localities and all areas.

Current Government Policies For Regulating and Eliminating Child Labour: The prime instrument of Government regulatory policy for curbing child labour is the Employment of Children Act 1991 which governs child labour below 14 years. It prohibits employment in transport, cement, carpets, clothes, dying and weaving, building and construction and hazardous industries. It also prohibits work between 7 pm and 8 am , sets the maximum daily working hours at seven, with a break of one hour after every three hours of continuous work, does not allow overtime and stipulates one-weekly holiday. Violations for breach of the Act is imprisonment for upto one year and a fine of Rs.20,000. In addition the Government took a number of welfare initiatives to encourage children to come back to school. The private sector and particularly trade export bodies are also discouraging child labour (e.g. the 'Child Labour Free Rugmark'. Despite all these initiatives child labour remains a major fact of life in Pakistan.

Proposed Policies For Eliminating Child Labour: The Employment of Children's Act 1991 was important because it showed that the sector responds to Government Penalties as is shown by the virtual absence of child labour in the prohibited sectors. A progressive approach to eliminating child labour is possible by combining the school education proposals made above with prohibitive legislation as follows: (i) Starting Year 2000 Middle School Education (upto age 12 or Class VIII) be made mandatory for boys and girls and the Employment of Children Act 1991 amended to prohibit employment below 12 years; (ii) Starting Year 2005 High School Education (upto Age 14 or Class X) be made mandatory for boys and girls and the Employment of Children 1991 Act be amended also to state that after 2005 employment of youth below 14 years is prohibited. It is also proposed that the movement from child labour to school enrollment be encouraged through publicly financed School Feeding Programmes for both private and public schools.

Employment Discrimination Against Women

The gender gap for females in school enrollment has been noted earlier. While there are pockets of traditional resistance against female education in some areas of Balochistan and the Frontier, this has largely been overcome over the last few decades throughout Pakistan. The substantially increased enrollment rates for primary education for both males and females are testimony to this and it has been the premise on which the previous recommendations on mandatory education for children through middle school immediately and through high school from 2005 were based. Pakistan's younger generation is quickly becoming better educated and in fact the younger generations of workers are almost all literate with some years of schooling. However, a more difficult task which now has to be faced is ending employment discrimination against women.

There has been improvement in female labour force participation rates over the past two decades but it has not been enough. For urban areas female labour force participation rates have increased from 3.6 per cent in 1974-75 to 8.4 per cent in 1996-97 while for rural areas they have increased from 7.6 per cent in 1974-75 to 16.3 per cent in 1996-97. Overall the increase in female labour force participation rates has been from 6.4 per cent in 1974-75 to 13.6 per cent in 1996-97.

Table-III.2: Pakistan Labour Force Participation Rates 1974/75-1996/97

	All Areas		Urban		Rural	
	Female	**Male**	**Female**	**Male**	**Female**	**Male**
1974-75	6.4	76.7	3.6	68.8	7.6	79.8
1984-85	8.7	77.1	4.0	72.6	10.7	80.0
1994-95	11.4	69.1	7.0	64.3	13.3	71.3
1996-97	13.6	70.0	8.4	66.5	16.3	71.8

Source: N. Mahmood and D. Nayab, "Gender Dimensions of Demographic Change in Pakistan" PIDE, 1999.

Government Policies Regarding Work for Women: Successive Governments in Pakistan (including two headed by a woman Prime-Minister) have only paid lip service to ending employment discrimination against women. The slight improvement in female labour force participation rates are only due to the push of economic factors. In the rural areas women are now almost exclusively actively involved in milk production and this has been a growing sector as discussed earlier. Similarly, women already constitute a little more than 30 per cent of the total teachers in the entire education sector in both urban and rural areas. This is primarily where the increased employment gains have come over the last two decades. Minor gains have come from increased employment in carpet making (replacing child labour), garments (particularly embroidery) and the services sector including public administration and the public and private financial sector- the last being largely confined to upper class, highly educated professional women.

Proposed Policies: Employment discrimination against women has been a historical fact in all societies and even till the end of the 1930's women in the USA (which even in 1930 was much more liberal than the Pakistan of 1999) largely faced an employment profile similar to that of Pakistan. For the USA gender discrimination came to an end with World War II with women having to "man" the offices and the factories. For Pakistan gender discrimination will only end with education. Therefore the proposed education strategy based on public and increasingly private sector schools (in Pakistan all the private schools are owned by women and largely employ only women) and on compulsory schooling for both boys and girls has profound implications for female employment. Making schooling compulsory for girls (and boys) will increase the demand by more than 100 per cent for female teachers. This, together with the more educated girls and boys who will enter the labour force in the period 2005-2010, will ensure the virtual end of gender discrimination in all sectors of the economy by 2010.

Unorganised Labour and The Elderly –Labour Laws, Pension and Social Security System Reform.

The SME system will only work if the labour force working in them (largely unorganised) are entitled to the coverage of humane labour laws and if pension and health benefits accrue to them and their dependants during their working lives and after their retirement. While this is applicable to all workers in all sectors of the economy, in Pakistan only medium and large scale establishments (covered by the Factory Act and employing 10 or more workers) currently are legally covered by EOBI (Pension) and Social Security (Health) Schemes. In practice, only employees of large scale enterprises benefit from these programmes. Accordingly the entire SME sector comprises largely unorganised labour which does not benefit from labour legislation.

As has been discussed earlier the emerging labour market and employment situation for the next decade shows that the overwhelming majority of the labour force will get employment in the small scale, labour intensive sector. The SME sector is not by definition 'backward' (as has been shown by world-wide and particularly the Italian experience). Increasingly in most cases they will become quite modern (shops, boutiques, catering houses, leather, machinery fabrication etc.). The large scale sector organised along factory lines will continue to expand, but its relative importance in the economy with regard to future employment generation will continue to diminish.

The structural change in employment towards SMEs which is under way and which is proposed to become the norm for employment in Pakistan has substaintial implications for the expansion and reform of the labour relations and industrial relations frame-work. The push by organised labour, Government Labour Ministries, the ILO etc. – has been focussed both to defend the benefits and legal safeguards that labour has achieved over the last few decades through tremendous sacrifices and also to expand benefits and the scope of existing labour laws to smaller and smaller organised units. This strategy now needs to be further developed. The aim should be to make labour laws sufficiently flexible, while retaining safeguards and benefits, so that the entire labour force can be brought into its ambit, whether it is the large scale or small and medium scale sector. A proposed strategy for reform of the labour relations and industrial relations frame-work is discussed below.

Preventive Laws – Regarding Workers Health and Safety: Preventive provisions regarding workers health and safety are given in the following laws: The Factories Act 1934, The Mines Act 1923, The West Pakistan Shops and Establishments Ordinance, 1969. These include standards on cleanliness, ventilation and temperature, humidity, overcrowding, lighting, precaution in case of fire, fending and guarding of machinery, precautions against hazardous occupations, etc.

The Factories Act applies to establishments with 10 or more workers; while the West Pakistan Shops and Establishments Ordinance covers all other establishments (with a few exceptions for non profit institutions, hospitals etc). It excludes households and agricultural labour. The Factories Act is fairly comprehensive on 'prevention' with 20 sections in the law covering the subject and a system of formal inspection with 'inspectors' of Factories. The Shops and Establishment Ordinance has only one section on prevention (viz. "in every industrial establishment, all mechanically or electrically propelled machinery shall be guarded in the prescribed manner"). The Act also lays down a formal system of inspection with inspectors of 'shops'.

It is recommended that the preventive provisions of the West Pakistan Shops and Establishments Act be strengthened (but not by the stringent standards of the Factories Act) and that all exceptions to the Act with regard to coverage be removed immediately with suitable amendments to cover households' employees and farm labour. This will safeguard the interest of the workers without diminishing flexibility in the system. The security of workers health and safety is an area which should be of prime importance in any reform of labour laws.

Preventive Laws – Concerning Working Hours: Maximum working hours per week (48) and hours per day (9) with limited provisions for overtime (15 hours/year) together with a weekly holiday are mandated both by the Factories Act and the Shops and Establishments Ordinance. There are some exceptions for technical staff. Overall these provisions are adequate for protecting labour and do not need major changes. However, the law needs to be expanded so that the same protection with regard to working hours is extended to household employees and farm labour.

Beneficial Laws – Minimum Wages: Minimum wages are regulated by the West Pakistan Minimum Wages for Unskilled Workers Ordinance 1969 and the Minimum Wages Ordinance 1961. The major 1969 Laws fixes minimum rates of wages for unskilled workers employed in industrial and commercial establishments of 50 or more persons (excluding essential services, Government and defense). The 1969 Law was amended by the Unskilled Workers (Amendment) Act 1993 to fix the minimum wage at Rs.1500 per month (with maximum deductions of upto Rs.25 p.m. for housing and Rs.10 p.m. for transport). The 1961 Law laid down minimum wages for certain industrial undertakings with regard to time work, piece work and work on weekly day of rest which are subject to renewal by the Tripartite Minimum Wage Boards set up by the Provincial Government.

It is recommended that the Minimum Wage Ordinance be extended to all paid workers including households and agricultural labour and all industrial, commercial and noncommercial establishments, regardless of the size of the workforce.

Beneficial Laws – Holidays With Pay: Workers right to holidays with pay is laid down by the Factories Act 1934, the Mines Act 1923, The Road Transport Workers Ordinance 1961 and the West Pakistan Shops and Establishment Ordinance 1969. The Shops and Establishments Ordinance allows 14 days of annual leave, 10 days of casual leave, 8 days of sick leave and 10 days of festival holidays (total of 42 days a year). However, as a result there is a conflict between the legal hours of work in the Government (with about 38 hrs/week) the organised private sector (42 hrs/week) and the unorganised private sector (which is not protected by any labour laws).

It is recommended that the standards of the West Pakistan Shops and Establishment Ordinance be made applicable to all employment in Pakistan.

Beneficial Laws – Financial and Welfare Benefits: Pakistan is fortunate in having on its books an extensive body of legislation which grants workers (in establishments employing more than 10 workers, and some cases more than 50 workers in the industrial and commercial sectors) an extensive system of financial and welfare benefits. Principal laws which govern this are: (I) The Employees Old Age Benefit Act 1976 (for pensions); (ii) The Provincial Employees Social Security Ordinance 1965 (for health benefits); (iii) Workers Welfare Ordinance 1971 (for housing); (iv) The Companies Profits Worker's Participation Act 1968 (for sharing profits); and (v) The Worker's Compensation Act 1923 (for death and accident benefits). All these laws need to be extended to the entire work force but with substantial modification in the case of the first four in order to make them more flexible, given the reality of the current and projected employment situation.

The Pension Scheme: (EOBI, 1976) currently applies to establishments with more than 10 workers and to workers earning up to Rs.3000 per month. It is financed through employers contributions of 5 percent and matching contributing from the Federal Government. The present scheme is a defined benefits scheme based on open group valuation and is basically unsustainable (that is, it promises benefits which will have to be changed downwards constantly over time as the scheme matures and early generations get collection and benefits administration). Its present coverage of 900,000 (including 95,000 pensioners) cannot possibly be extended to the entire employed labour force in the future given the structural nature of the projected employment.

It is proposed that the old-age pension scheme coverage be extended in a phased manner from the present level of less than 1 million to about 8 million SME employed urban and rural non-agricultural workers by the year 2000 and to cover agricultural workers (10 million) by the year 2005. The nature of the pension scheme will have to be flexible with workers allowed to choose between the existing EOBI scheme and an Individual Pension Scheme which will have the following features: (i) Fully funded defined contribution scheme; (ii) Individual pension accounts for all including seasonal, contract and piece rate labour maintained by individual workers themselves in pension 'books" held at designated banks (with the total pension fund being held and invested centrally); and (ii) Equal employer/employee contribution of seven percent of wage each (introduced gradually for employees and the government phased out).

Health Insurance: (SSO, 1965) Financed through employers contribution of 7 per cent of wages is offered to establishments of more than 10 workers through Social Security Institutions in the Provinces which maintain Social Security Hospitals. The promised benefits again are not sustainable (and would cost at least Rs.3000 per month if offered privately rather than the maximum subscription of Rs.210 per month collected today). It is proposed that the health coverage be expanded at the same rate as the pension coverage, that the 7 per cent of pay which is employers contribution be matched by a 7 per cent employees contribution (introduced gradually over time) and that the workers be allowed to choose between joining the existing Social Security Organisations with their own hospitals or be allowed to join Health Maintenance Organisations (HMOs) to be established by the newly autonomous public hospitals and the private sector.

Worker's Housing: (WWO, 1971) is financed through a 2 per cent levy on assessable company income in excess of Rs.1 lakh which goes into a Workers Welfare Fund (WWF) which also receives 'excess' of workers entitlement to profits under the Workers Profit Participation Act. The WWF has generally not been used well with only a limited member of housing units constructed and the general use of these funds has been to provide free bicycles, sewing machines, grants for *Jahez* etc. The WWF has built up substantial liquid balances.

It is proposed that the WWO be extended to all workers (in line with the expansion of the pension and health schemes) and that an alternative minimum contribution of Rs.25 p.m. be required (since many companies declare no profits). The money should be put into a Workers' Housing Bank which should provide financing for workers housing using the funds generated as an interest rate subsidy.

Workers Participation in Profits: (CPWA, 1968) is based on 5 per cent of company profits exceeding 1 lakh to be distributed to workers subject to limits of 100 per cent of monthly wage not to exceed Rs.3000. The excess is to be deposited into the Workers Welfare Fund.

This law should also be extended to cover all categories of establishments including farming establishments (in line with the expansion of the pension and health schemes) although for obvious reasons it cannot be extended to household and not-for-profit organisations. Some changes need to be made in the law to prevent misuse of liquid funds (held for substantial periods of time) by the Workers-Employers Committees.

Laws on Industrial Relations: Trade Unions, Management – Labour relations, collective bargaining and dispute resolution machinery are regulated by the Industrial Relations Ordinance 1969 which derives its main force form the ILO Conventions 87 and 98 as ratified by Pakistan. Trade Union activities are permitted with 10 per cent representation of the office bearers from outside the organisation. There is no restriction on the number of unions within an organisation except that they have to be registered. The registered trade unions have the privilege of contesting elections for the determination of Collective Bargaining Agent (CAB) – the representative body having the authority to negotiate with the employer. This law should be amended in line with developments in the developed countries to cover SMEs.

Laws on Hiring and Firing: Employers' right to hire and fire in establishments with 50 or more workers is nominally subject to one months wage in lieu of notice (West Pakistan Industrial and Commercial Employment Ordinance 1968). Reason has to be given in writing and workers may appeal under S.25 of the Industrial Relations Ordinance 1969 to the employer directly or the Collective Bargaining Agent and if dissatisfied with the decision, take it to an Industrial Labour Court. The Procedure restricts the right of employees to hire and fire. It is proposed that the above laws be amended to cover SMEs but recognising the special conditions of SMEs, employers be given the unrestricted right to hire and fire with two months wage for each year of service as compensation.

Conclusion

Pakistan is historically uniquely placed in that it can further protect its vulnerable groups – children, women, unorganised labour and the elderly by its SME agenda to focus on universal school education and the strengthening of its labour and social security laws. The proposals in this section are intended to achieve this objective.

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