PRIVATE SECTOR ASSESSMENT (SUMMARY)[1]

1. Sector Performance, Issues, and Challenges

1. **Sector synopsis.** With the exception of a brief period of nationalization during the early 1970s, the private sector has been the primary producer of goods and services. The private sector owns 100% of textile and telecommunications companies, and a significant majority of financial, cement, sugar, automobile, energy and fertilizer enterprises. Private power generation assets contributed approximately 50% of power generated.[2] With the successful privatization of the Karachi Electric Supply Corporation (now known as K-Electric), private entities have successfully entered into electricity distribution as well.

2. Relative macroeconomic stability during fiscal year (FY) 2000−FY2007 and the accelerated process of privatization in the 1990s and early 2000s boosted investment in the private sector, including more foreign direct and portfolio investment. Domestic capital markets have experienced some development; these cover ordinary shares, derivatives (futures), term-finance certificates, mutual (conventional and Islamic) funds, and pension funds. As of 30 June 2015, the Karachi Stock Exchange had 581 listed companies and a market capitalization of PRs 7,421 billion.[3] Furthermore, the KSE 100 index, which hovered around 2,000 in 1999, reached a level of 34,399 as of 30 June 2015 (footnote 3). But the number of shares that were freely available to be traded in most companies is very small; a few very large corporations dominate the market, and the number of companies listed declined.

3. Key constraints to private sector participation in the economy are the (i) lack of macro-economic stability; (ii) weak infrastructure services, especially in energy; (iii) deficient trade policy; (iv) poor business environment; (v) shallow financial markets; and (vi) security challenges. Despite the country's slight improvement in the World Economic Forum Global Competitiveness Index (from 133 in FY2014 to 129 in FY2015, out of 144 economies),[4] its ranking remains low, and highlights the need to address private sector growth constraints. Pakistan fared poorly in the areas of institutions, macroeconomic environment, health and primary education, higher education and training, goods market efficiency, labor market efficiency, and technological readiness. Pakistan ranked 110 out of 189 economies in the Doing Business 2014 report, compared with an average rank of 121 for South Asia.[5] Pakistan compares well in the overall ease of doing business, but it fares worse in key areas (e.g., starting a business, registering property, getting electricity, paying taxes, and enforcing contracts). More recent data in the Doing Business 2015 report, and a change in methodology, has adjusted Pakistan's 2014 score to 127, which declined slightly to 128 in 2015.[6]

4. **Macroeconomic trends.** Pakistan's long-term economic performance is characterized by cycles of rapid growth followed by sharp slowdowns, often coinciding with balance of payment problems. For example, following rapid economic growth (with an average growth rate of 6.6% during FY2004−FY2008), Pakistan's economy faced balance of payments problems in 2008, which contributed to much weaker growth rates beginning in 2009, with annual economic

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[1] This summary is based on Government of Pakistan, Planning Commission. 2010. *Private Sector Development Task Force Report* .Islamabad. http://documents.worldbank.org/curated/en/2010/03/16270693/private-sector-development-task-force-report) and ADB. 2008. *Pakistan Private Sector Assessment*. Manila.

[2] National Electric Power Regulatory Authority. 2013. *State of Industry Report 2013.* Islamabad.

[3] KSE Stocks. http://www.ksestocks.com/ListedCompanies/SortByName and Securities and Exchange Commission of Pakistan. 2015. http://www.secp.gov.pk/divisions/Portal_SMD/DailyMarketReport/DMR-2015/30-06-15.pdf

[4] World Economic Forum. 2014. *The Global Competitiveness Report 2014−2015.* Geneva.

[5] World Bank. 2013. *Doing Business in Pakistan 2014*. Washington DC.

[6] World Bank. 2014. *Doing Business in Pakistan 2015*. Washington DC.

growth averaging 3.5% for FY2010−FY2014. The underlying structural reason is insufficient domestic savings to fund required investment, with private sector exports that are unable to compensate for growth-related import demand. An improved investment climate, better public sector governance, and resolution of the energy crisis are prerequisites to rekindling private sector development.[7] Economic growth can only be sustained by raising domestic saving and investment rates, and implementing policies that facilitate export development and industrial transformation to develop comparative advantages in products with higher income elasticity of demand (i.e. more sophisticated products).

5. **Structure.** The economy is driven by the services sector, which represents 58% of gross domestic product (GDP) and experienced an average growth rate of 4.8% during FY2005−FY2014. Industrial output represents 20.4% of GDP, with an average growth rate of 5% over the same period; the growth rate has been volatile because of the country's inadequate power supply resulting in an average growth rate of 6.4% during FY2005−FY2009, and a weak 3.5% during FY2010−FY2014.[8] Agriculture's share of GDP dropped from 22.5% in FY2005 to 21.2% in FY2014. The oil and gas, telecommunications and financial sectors were major areas of private investment during FY2005–2014. Manufacturing investment accounted for only 13% of gross fixed capital formation in the private sector in FY2014, compared to around 50% for the services sector, and is expected to remain limited while energy problems, security challenges, and stagnating exports persist.

6. **Infrastructure constraints.** The key infrastructure constraint remains the critical and crippling infrastructure deficit, particularly with respect to power, gas, transportation and urban infrastructure. When combined with the deteriorating security conditions, this has caused a significant part of the country's textile industry—and value-added potential—to shift overseas. Infrastructure investments need to be accelerated, along with reforms and a stronger (but efficient and rapid) regulatory and policy environment, with the goal of ensuring sufficient, uninterrupted availability of power and gas for industrial and commercial use, and efficient transportation channels for product distribution.

7. **Public–private partnerships.** The gap between Pakistan's infrastructure needs and available fiscal resources can be filled in part by public–private partnerships (PPPs), which are a generally well-accepted procurement modality. PPPs have fiscal risks that need to be mitigated and managed, and the government needs to develop the required technical sophistication to enable it to identify, structure, and eventually pursue PPP proposals that can maximize value-for-money for taxpayers. The power generation sector in Pakistan has been developed under PPP arrangements. The federal government needs to provide support to other infrastructure services in the form of minimum revenue or viability gap guarantees, which can act as a safety net by mitigating the commercial risk relating to a project, while creating incentives for the private sector to generate core and non-core revenues. PPP development requires close coordination among federal and provincial governments.

8. **Financial sector.** Despite a modern regulatory framework for banking, Pakistan's financial intermediation is low compared to its peers. Domestic credit to the private sector was only 15% of GDP in FY2014, down from 22% in FY2009. The massive surge of public sector borrowing undermines private access to credit at affordable prices. Financial inclusion remains very low and access to credit is worsening, with just over 10% of the adult population having an account at a formal financial institution.[9] The insurance and leasing subsectors are

[7] Government of Pakistan. 2014. *Pakistan Economic Survey 2013−14*.Islamabad.
[8] Sector Assessment (Summary): Finance (accessible from the list of linked documents in Appendix 2).
[9] International Monetary Fund. Access to Finance Database. http://www.imf.org/.

underdeveloped. Capital markets lack financial instruments and institutions that specialize in long-term debt or infrastructure finance, which helps to slow industrial growth and narrow the industrial base.

9. **Trade policy.** Pakistan lags behind its regional peers in promoting policies that are conducive to the growth of mineral extraction, tourism and other export-oriented sectors that could generate foreign exchange revenues. It has continued to rely on workers' remittances and foreign capital inflows to finance fuel and other imports. It is vital that the country implement an export-oriented industrial development strategy.

10. **Allied challenges.** Labor laws tend to favor rent-seeking behavior by those who are responsible for their implementation. The current state of land records limits the ability of investors to unlock capital for potential business activities, although the government has started digitizing land records. Current business laws make it difficult for firms to enter, operate and do business in the country. Laws governing mergers and acquisitions, bankruptcy and insolvency, and competition need to be modernized and enforced in a timely and consistent manner to reduce the time and resources expended by businesses. Reforms since the current government came to power in mid-2013 have produced some improvement in the investment climate, but continued efforts are needed to restore private sector confidence. This requires developing energy supply and other infrastructure, investor friendly competition and investment policies, contract enforcement and dispute resolution mechanisms, independent and competent regulatory institutions, and alleviating security challenges.

2. Government Strategy

11. The current government views the private sector as a significant partner in the financing and implementation of gas, power and other infrastructure projects. Pakistan's liberal investment policy is one of the most attractive in the region. It allows full ownership by foreign investors in many sectors and unhindered remittance of capital, profits and dividends. In line with the country's liberal investment regime, the government issued the Investment Policy 2013 that reiterates and reinforces components of previous policies, consolidates existing policies issued by various ministries, and introduces further liberalization, in particular (i) reduced cost and processes of doing business; (ii) creation of industrial clusters and special economic zones; and (iii) linkages among trade, industrial and monetary policies. The government has also embarked on an ambitious privatization program, whereby it intends to undertake divestments with management control, as well as divestments through secondary public offerings in the international and domestic stock markets. Among the firms the government plans to privatize are the Oil and Gas Development Company, Pakistan Petroleum, Pakistan International Airlines Corporation, Faisalabad Electric Supply Company, and Lahore Electric Supply Company.[10]

3. ADB Sector Experience and Assistance Program

12. ADB supports private sector development in Pakistan through sovereign and non-sovereign operations. Sovereign operations have (i) supported small and medium-sized enterprise (SME) development; energy sector reforms; and the insurance, pension and provident fund subsectors; (ii) improved operation of the stock exchanges; (iii) increased access to trade finance for SMEs; and (iv) microfinance. Future ADB sovereign operations will provide loans that support the government's policy reform agenda of developing a sustainable energy sector, plans to privatize and restructure public sector enterprises, and strategies to address

[10] Government of Pakistan. Privatisation Commission. http://www.privatisation.gov.pk/Transactions/Upcoming%20Transactions/Upcoming%20Transactions.htm.

the binding constraints to the development of PPPs. ADB will provide technical assistance that can increase the availability of financing for infrastructure projects from conventional bond and *Sukuk*[11] markets, develop the environment for PPPs, increase availability of transaction advisory services for PPPs, support investment in mineral and other export-oriented sectors, and help increase access to financial services by agriculture and SMEs. ADB may also use its guarantee and other credit enhancement products to support conventional bond and *Sukuk* issues by sub-sovereigns, special purpose vehicles, and funds to finance infrastructure projects undertaken by the public sector or through PPPs.

13. ADB's non-sovereign operations have and will continue to focus on direct loans, guarantees and equity investments in private entities that benefit from or complement its sovereign operations. Since 2007 ADB's non-sovereign operations have been concentrated on supporting private power projects. In view of the serious power shortages that continue to constrain economic growth ADB will continue to concentrate on private investments in renewable energy generation (hydro, wind, and solar);[12] development of domestic energy resources (gas field development and power based on captive gas fields); upgrading of power utilities (K-Electric); and investments in energy security infrastructure (such as liquefied natural gas). During 2009−2014, ADB's trade finance program supported 1,916 transactions in Pakistan totaling $6.9 billion. ADB currently has limits for eleven issuing banks with an aggregate exposure limit of $605 million. To support financial inclusion of the highly underserved population, in October 2013 ADB approved the Rural Financial Inclusion and Growth Facility. This guarantee facility, which is based on a four-party risk sharing arrangement, provides investment loans to small dairy farmers to increase their productivity and income.[13] The facility constitutes an innovative inclusive business solution through corporate and bank partners.

14. Pakistan's low credit rating constrains the growth of new non-sovereign transactions. Notwithstanding this limitation, ADB will continue to (i) explore ways to leverage its capacity and mitigate risk through the use of credit enhancement products and local currency-denominated loans and guarantees; and (ii) seek investment opportunities with private partners that support financial inclusion, especially in underserved rural areas, agriculture value chain financing, and access to education and health.[14] ADB will continue to support infrastructure investments in power (including liquefied natural gas import terminals and gas pipelines); transport (ports, dry ports, airline and railways); and logistics and agriculture; and may consider support for investment in urban water supply, solid waste, minerals and other export-oriented sectors, subject to careful review of regulatory and legislative frameworks to ensure that licensing, environmental and revenue sharing safeguards are in place.

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[11] *Sukuk* is an Islamic financial certificate or instrument, similar to a conventional bond, which complies with Islamic religious law.

[12] ADB participated in financing Pakistan's first three private hydropower and first three private wind power projects by leading the structuring, and mobilizing co-financiers, including the Islamic Development Bank, International Finance Corporation, Proparco and local commercial banks. The 84 megawatt New Bong Escape Hydropower project, Pakistan's first private hydropower project, became operational in March 2013.

[13] Under the program ADB enters into partnerships with domestic banks, dairy companies, and the State Bank of Pakistan as the executing agency for assistance from the United Kingdom Department for International Development.

[14] In the design of products for financial inclusion, a gender analysis will be conducted, as appropriate, so that women will substantially benefit from these opportunities. In 2013 ADB approved a $1.1 million grant for an e-learning service to explore and design strategies for broad-based integration of information communication technologies in basic education and technical and vocational training.