Industrial Policy for the Punjab
Strategy Concept Note

Introduction & Context

The Punjab accounts for about 60 percent of value-added—of which nearly 80 percent is provided by large scale enterprises— in Pakistan's manufacturing sector. However, despite such major stakes in the sector, the province has never had a comprehensive policy for encouraging the growth of industry. What efforts there have been, have been piecemeal. The last attempt at developing an industrial policy occurred in 2003, when the most significant initiative was to establish the Punjab Industrial Estates and to introduction of a nonintrusive labour regime. Whatever may be the merits of such initiative, they do not do justice to the large economy of the province, which requires a more dedicated and consistent policy to harness its manufacturing sector.

Of course, the role of the province must be nuanced, because some of the most powerful tools shaping industrial strategy—such as import policy, fiscal policy, and monetary policy—are in the hands of the federal and not the provincial government. However, there is still much that the provincial government can do—for example, focusing on key sectors as main drivers of growth with remaining industry piggy backing on their success, providing easier access to, and strengthening property rights over, land; improving provision of suitable industrial land by establishing modern industrial parks and zones; better aligning the education and training systems with the requirements of industry; improving the transport and logistic infrastructure; strengthening the quality and standards regime and provide support to industries to meet standards; removing bureaucratic hurdles to the establishment and functioning of enterprises; strengthening the commercial judicial system to speed up the enforcement of contracts and the resolution of disputes; and so on. Moreover, where the province has no direct constitutional hold, it can develop evidence based policy reforms and advocate strongly with the federal government to address these issues.
The Punjab Growth Strategy 2018 has described a role for the provincial government to enhance the performance of its industrial sector by; "*brining improvement in the functioning of industrial estates by providing critical infrastructure and creating clear property rights; reducing the cost of doing business particularly in the industrial clusters through improvements in the provincial regulatory framework. Government of Punjab will work with the Federal Government to overcome the critical shortage of*

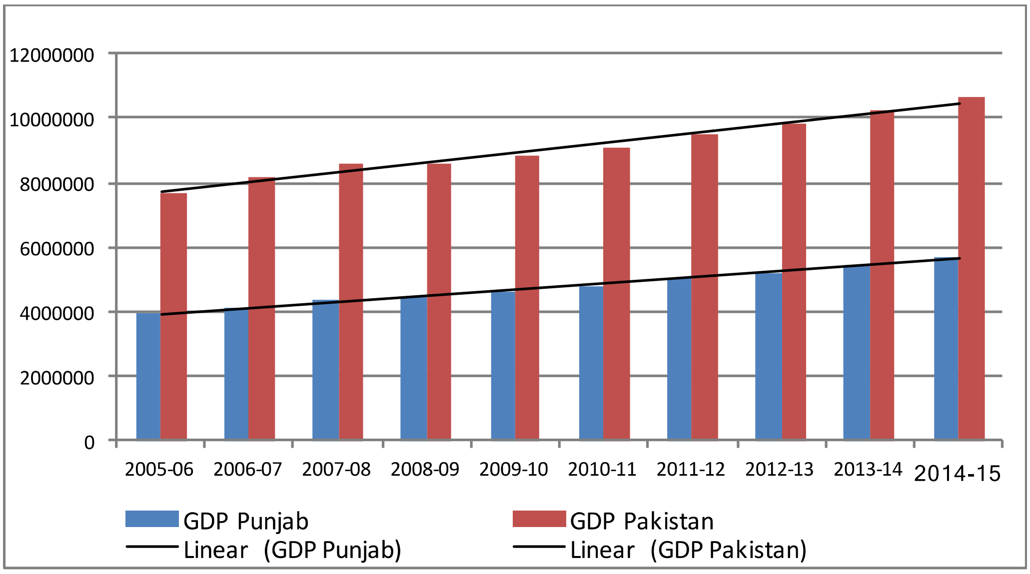
electricity, improve unfavourable trade policy hampering exports, improve restrictive international market access and enhance product quality and safety standards."

The discussion above points clearly that the Punjab will require a clear and consistent policy framework to divert its investment and those of the private sector towards greater industrial growth and productivity. This paper sets out a broad strategic framework for moving toward developing an industrial policy for the Punjab. The purpose of this paper is to highlight the key pillars of the provincial industrial policy, their importance and broad strategic directions to formulate detailed policy frameworks. It is expected that this paper can form the basis of developing detailed TORs for the development of Industrial Policy.

Industrial Sector of the Punjab: Its Structure, Importance & Performance

The Punjab is the heart of Pakistan's economy, and accounts for almost 60 percent of the country's annual production of goods and services (see Figures 1). The weight of the province in the total ensures that the performance of the national economy remains strongly correlated with that of the Punjab's economy.

Figure 1: GPP of the Punjab and & GDP of Pakistan, 2005-2015 (Rs million)



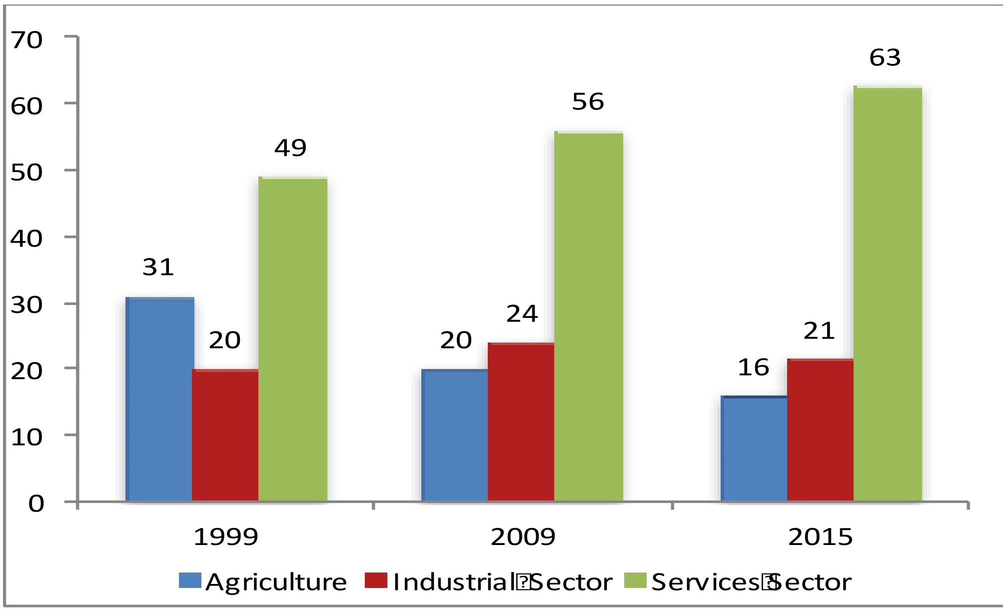
Source: Punjab Bureau of Statistics

Structural Share & Importance

The structure of the Punjab's economy has changed over the years, with the share of agriculture shrinking and that of services expanding.

The size of the Punjab's services sector has more than doubled in the last 25 years, whereas that of industrial sector has stayed stagnant (Figure 2). This stagnancy suggests that the actual number of industrial units/their productivity may have reduced once we take account for increased prices. In terms of employment the manufacturing sector employees around 5.4 million of the total 35 million employed in the Punjab (16%). This is clearly below the actual potential of the manufacturing base in the Punjab.

Figure 2: Structural Change in the Punjab's Economy (1999-2015) (%)

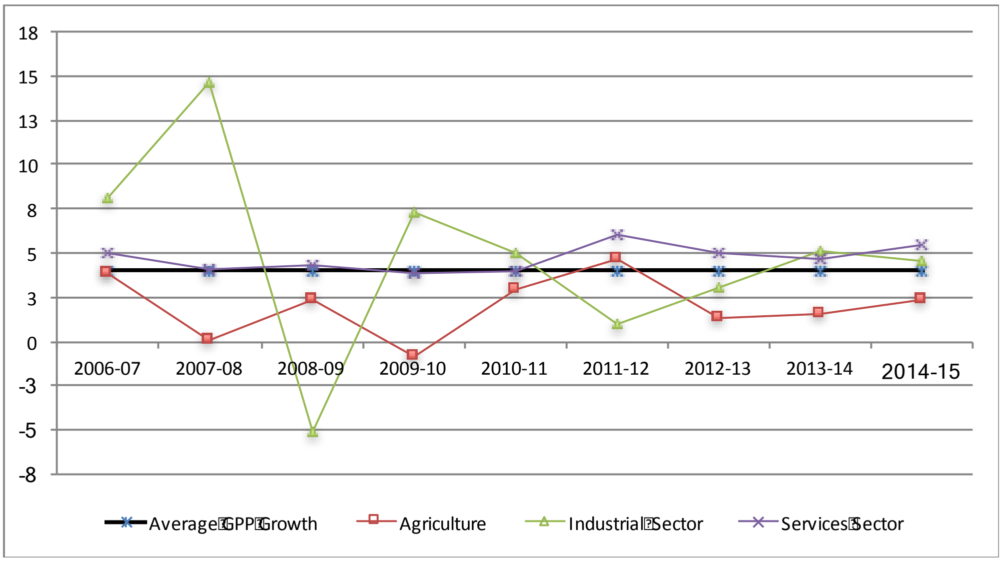


Source: Punjab Bureau of Statistics

Performance of Manufacturing Relative to Other Sectors in Punjab

Figure 3 below the performance of manufacturing sector as a whole relative to other sectors. The performance of manufacturing has been stronger than that of agriculture, however, lagged behind the performance in services sector. Moreover, the performance has been variable with large spikes between 2006-12, mellowing down in recent years.

Figure 3: Performance of Key Sectors in the Punjab (2006-2015) (%)

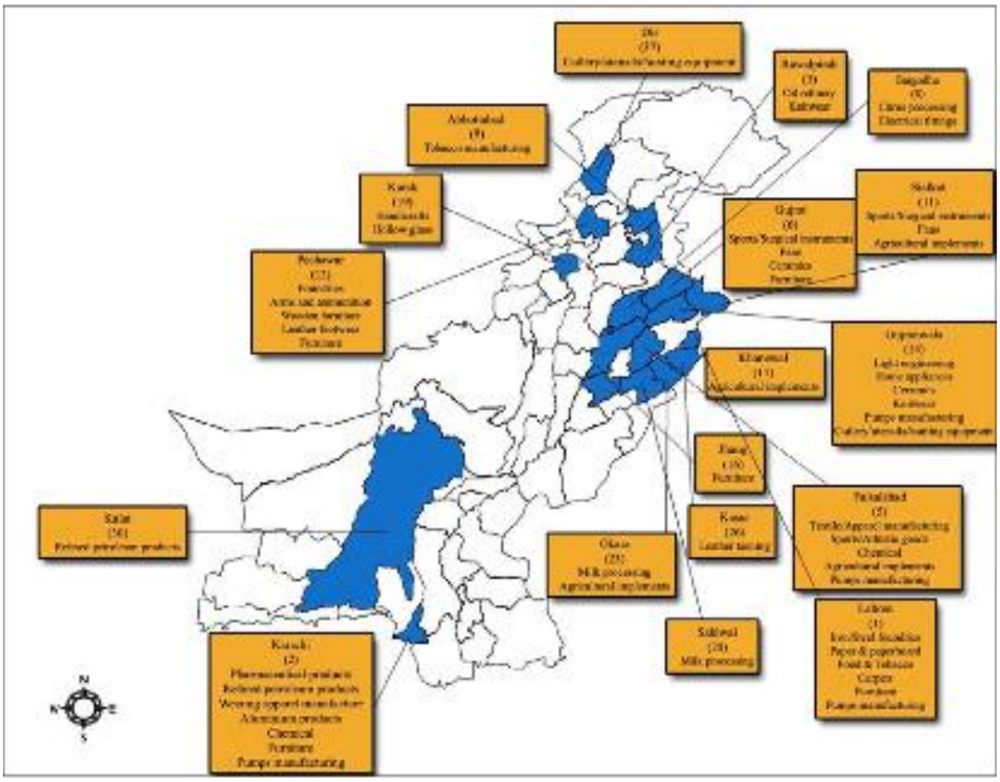


Source: Punjab Bureau of Statistics

Presence of Clusters

Punjab is house to a large number of clusters/semi clusters mostly located in central and norther part of the province (see Figure 4).

Figure 4: Mapping of Clusters in Pakistan & Punjab (2005-06)



Source: Census of Manufacturing Industries Data 2005-06

The Challenge

Growth Targets for Industrial Sector in light of historic performance

The Punjab Growth Strategy has set an ambitious target of an annual real growth rate of 8% for Punjab GPP by 2018.[1] If average performance over the last decade continue (2% for Agriculture, 4.8% for Services and 4.5% for manufacturing) the GPP growth will be around 4% - which is half of the target growth. Moreover, if performance of agriculture and services stay at these historic levels, then the Industrial sector will need to achieve a return as high as 24% real growth annually till 2018, to achieve an 8% overall GPP growth target. This is almost 6x the current average performance and much higher than the highest growth (14%) achieved in the last decade by the industrial sector.

Therefore, if the services and agriculture sectors double their average growth rates for the next three years i.e. growth rate of agriculture becomes 4% and that of services becomes 9.5%, then the **industrial sector will need to grow at around 8% annually** in order to achieve the GPP aggregate growth rate of 8% p.a. by 2018.[2]

Sustaining this growth in the industrial sector that is almost 100% higher than the average performance becomes an even bigger challenge under current situation. The absence of a clear strategy for manufacturing in the Punjab has created, through the accretion of uncoordinated measures, an approach to industrial development that is neither fish nor fowl. Federal and provincial government actions have generated a patchwork of incentives, a haphazard distribution of import protection, subsidies, and infrastructure access, while the province's education and training systems often bear little relation to the requirements of a modern economy. After 65 years, the Punjab is saddled with an industrial structure that is concentrated in the production of relatively few items and is biased towards those of low value-addition. Without the articulation and implementation of a clear strategy, the manufacturing sector of the Punjab will remain mired in the production of items that sit low on the value chain.

[1] Based on the current situation this target may have to be revised.

[2] These numbers are based on GPP breakdown estimated done by Punjab BOS. These numbers are broad estimates and several studies in the past have highlighted the need for Punjab to develop robust numbers of its provincial economy. The anlysis based on estimated numbers may some degree of errors.

Past studies show that most industrial sectors in the Punjab (generally in Pakistan), has failed to move into more sophisticated products. The structure of incentives has encouraged industry to remain predominantly in the production of items that are either losing market share or those that fetch low prices. The lack of incentives to innovate or to improve competitiveness has enabled industry to live with outdated production techniques and a labour force with low technical skills. All of this will have to reverse if the sector has to contribute towards the targeted growth levels.

Response to the Challenge

To respond to this challenge, the Punjab Government through the Industries Commerce & Investment Department is developing a medium term industrial policy to enable the sector contribute its share in the provincial growth targets. The Industrial Policy will be based on four (4) key pillars namely:

1. Differential focus based on the size of Industry
2. Competitiveness of key sectors within global value chains
3. Spatial clustering of key industrial sectors
4. Provincial and national policy reforms to create an enabling environment for the industry

More specifically, the 4 pillars of the Industrial Policy will cover:

1. *<u>Differential Focus based on the size of the economy</u>*

Punjab is endowed with industry of variable size. The government realizes the fact the needs of the industrial sector are highly correlated with their size. Hence, the strategy to develop Industrial Policy is to take a differential approach based on the size of the industry. The policy will develop separate interventions to develop its large manufacturing base, SME and small/cottage industry.

Punjab has a concentration of large manufacturing sectors such as chemical industry, steel manufacturing and fertilizer industry. These sectors are important not only in terms employment and revenue generation, but also as significant contributors in supporting the competitiveness of the value added Industry. All value added industry, be it textile, leather, engineering or food processing is dependent on inputs produced by these industrial sectors. If Punjab has to improve its industrial competitiveness it will have to significantly upgrade and strengthen these primary/ancillary industries.

The Industrial Policy will develop specific targets and policy intervention to attract greater investment in these sectors. Moreover, Punjab has a rich resource of iron ore, the policy will look at creating incentives to attract investments that will trigger full utilization of these untapped potential. The policy will clearly state the stance of the provincial government and its expectations from this sector.

Punjab is also endowed with a large number of SME industrial sectors. It comprises both value added knowledge based sectors such as auto-parts, pharmaceutical and electronics industry and value added skill and engineering based sectors such as light engineering (comprising a large variety), leather, footwear, garments, gems and jewellery, furniture and several others. Most of these industry fall in the category of SMEs. The objective here is to develop policy options that are most suited to the needs of SMEs.

Finally, Punjab also has a large base of cottage and small scale industry. This industrial base spans the entire geography of the province and also depicts regional cultures and specializations. For example, Wazirabad is famous for small cottage manufacturers making high value daggers and hunting knives and similarly Multan is enriched with blue pottery products. The Southern part of the province has a large number of craft industries that feeds into the sustenance of a large number of people. The focus at this sector will allow for both economic and social impact.

The policy will clearly define these size differentials and based on their spatial aspects develop key targets and interventions.

2. *Competitiveness of key sectors with respect to global value chain*

The Punjab Growth Strategy 2018 identified certain key industrial sectors based on their export and local market potential, employment impact and investment growth. These priority sectors under the Industrial Policy will be clubbed into 4 segments comprising; (i) Garments, sportswear and leather textile; (ii) Light engineering sector including auto-parts; electronics, surgical & steel instruments and home appliances; (iii) value added agriculture, agro—food and agriculture marketing and; (iv) footwear, leather and sports goods. These sectors have been combined with respect to their similarities in terms of spatial characteristics and production processes, including souring of capital and labour inputs. The Industrial Policy will be based on a common framework (to be developed as part of the process toward developing the industrial policy) on which these sectors will be calibrated and appropriate policy options/interventions will be designed. The common framework will at least include:

- Comprehensive spatial mapping and geo tagging of the industrial establishments
- A comprehensive data on production, employment, exports, associated vender industry, imports, technology and production processes
- A competitiveness positioning of the sector relative to global value chain of sector
- Potential of export and any intra-industry regional trade
- Distribution and marketing channels for local sales
- Specific policy options to improve sectors competitiveness
- Policies that can/will attract more investments (both domestic and foreign) into the sector
- Policies that will develop the support / ancillary industry for these sectors
- The policy document should be able to develop simulated numbers suggesting target contribution of these sectors to employment, output and growth. Any policy incentive announced must be tied to sector achieving agreed targets
- The policy should also institutionalise sector relevant PPD forums to keep track of policy implementation and tracking of results
- Trade policy and trade agreement interventions that can be advocated with the federal government.

3. *Spatial clustering of key sectors*

A key reason behind inadequate performance of the industrial sector is its ill organized and fragmented spatial structure. Historically, in the Punjab (apart from few announced zones and industrial parks) land has always been classified as residential or agriculture. Consequently, a lot of industry established in Punjab now find themselves located in middle of dense residential and commercial establishments. This only increases the operational difficulty for these units but also raises environmental issues and hazards putting lots of lives at risk. To address these issues, the Industrial Policy will develop a clear stance on developing industrial parks and zones. The Industrial Policy will develop a comprehensive assessment of existing industrial parks and zones and develop a clear investment and upgradation plan and wherever possible explore options of private sector management taking control under a set of predefined governing rules. The policy will also cover the futuristic role of PIEDMC if the province goes for large scale investments in setting up cluster specific zones. Moreover, these zones/estates should follow basic guidelines to encourage relocation and investment by the industry. Based on the experiences of other countries the estates at the minimum must offer:

- Low cost land with clear titles and developed to a stage where it is suitable for construction of heavy industry. The size of each zone must be determined on the existing and anticipated size of the sector. For example, there are around 300 footwear factories in Lahore/Punjab and allowing for reasonable growth one can assume that land allocated for a dedicated footwear park should be sufficient for at least 500 units to allow new companies especially foreign owned enterprises to invest in the sector and also some support industry like those producing accessories.
- A one window operation for all provincial government registrations, taxation, monitoring and compliance. The work force for each unit may be registered with the park authority who can be made responsible for managing EOBI, SS and other worker benefits.
- Minimum standards on infrastructure so that the industry is able to meet environmental standards not only locally but those of international markets.
- Subsidy on land cost where companies bring in JV partners with high element of technology transfer.
- Courses relating to international trade laws and local laws affecting manufacturing and local and international trade.
- The Park Authority be it PIEDMC or a new entity should include representation from industry and should serve as a proponent of key policy measures that will accelerate the growth of the sector in the Punjab. The PPD institutional forum should be made part of the work-plan.
- Tax breaks and incentives as managed through advocating with the federal government.

- Captive power generation that may be outsourced to private sector, however, the provincial authorities should support all negotiations with the federal government in terms of setting tariff and power distribution.
- The parks/zones should be provided adequate security of assets and human life and also appropriate linked with road and logistic intrastate for easy in and out flow of goods.

4. *Provincial and national policy reforms to create an enabling environment for the industry*

Under the last pillar the Industrial Policy will develop intervention and outcomes to address key horizontal issues and impediments to industrial growth and development. The key areas here will include:

Business Environment Reforms: This will include both aspects that are in provincial domain and those that are under federal but are impeding growth of the industrial sector. Areas under the provincial government include local taxation, registration and payments for EOBI and Social Security, Land titling and registration process, issues with planning including at local TMA level and LDA, other intrusive behaviour by inspectors such as Dengue inspections, building fitness certifications and environmental compliance. The provincial interventions will also cover setting up policy dialogue institutional setup and also a central repository of knowledge and information to assist industry. The areas that will be advocated strongly with federal government would include national taxes, business registration costs and delays, connections and availability of utilities and with State Bank on developing credit policy focus geared for SME development.

Provincial Investment Policy: To aid implementation of industrial policy an investment policy will be developed that will provide a priority list of sectors where the province is encouraging investment, partnership modalities and host of incentives such as subsidized land, tax break on provincial taxes and other negotiated benefits may be offered.

Trade Policy Issues: There is lot of international evidence in favour of carefully designed trade policy initiatives that have worked wonders for local industry development. Vietnam is a key example, where they have been able to use their trade agreements with the USA and the EU to graduate their footwear and garments industry from scratch to multi-billion export oriented industries. Based on large export market potential a large number of foreign owned enterprises partnered with local industry to set up latest technology equipped production plants that captured significant export market shares. Punjab Investment Board under the policy will develop key options for such trade policy interventions that will be advocated with the federal government.

Upgrading the Human Resource in the province: One of the key issues that has historically eroded competiveness of Punjab's industry is the deteriorating levels of skills availability in the province. The Industrial Policy will establish a strong link with the skills policy of Punjab, an area that has also been highlighted as a key pillar under the Punjab Growth Strategy 2018. The policy will look to reform existing public sector institutions such as TEVTA, PVTC, PBTE and TTB to make them more market and demand oriented. Moreover, the government will use PSDF to create a facilitative environment for private sector skills providers to contribute more strongly. The objectives here will be to upgrade skills in Punjab that meet industry standards and requirements and can poise Punjab's labour productivity close to its international competitors.

Quality Standards & Compliance: Most of the industrial produce in the Punjab is unregulated and as such does not comply with any standards of safety and quality. The sectors that target export markets spend fortunes to build their capacity to comply with these foreign or buyer driven standards. Lack of local standards means that industries have to take a larger plunge when trying to comply with international standards, which is both difficult and expensive. Moreover, lack of local standards also acts as a deterrent to growth as they distort competition. The forms that are trying to grow by producing quality products fail to compete with firms on cost who are producing low quality products. It is essential that the Punjab's Industrial Policy develops clear guidelines to address this issue.

CPEC: Punjab expects to benefits majorly from the projects that will flow out of CPEC and the trade routes that will open up. However, in order to benefit from this dividend of Chinese Investment Punjab will need a clear and futuristic policy. The policy must be intertwined with the industrial policy, especially the part where zoning is done for development of industrial estates, investment made in road and power infrastructure and establishment of new cities along the corridor. In short the policy on CPEC must be an internal part of the Punjab's industrial policy.

Conclusion

This short concept note provides a skeleton structure of key components for the development of Punjab's Industrial Policy. It is expected that the actual policy document will be a compendium of policy notes for each of the areas highlighted in this paper. The Industries Department based on this paper will now develop specific TORs for the development of the actual policy document.