

CHAPTER 3: PRIVATE SECTOR DEVELOPMENT

A. THE CHALLENGE AND THE OPPORTUNITY

3.1 As discussed in Chapter 1, it will not be possible to reduce poverty in the NWFP without accelerating the growth of the province's GDP, and this growth must come primarily from the private sector. Growth at a pace that will significantly improve the unemployment and poverty situations will require a major increase in investment or an increase in productivity. But constraints on the provincial government's budget will limit the expansion of public sector investment. Thus it is unlikely that public sector efforts alone will be able to lift the investment/GDP ratio to the level necessary to generate growth that will produce the requisite number of jobs. The private sector will have to step in with the additional investment.

3.2 In addition to broad-based growth, the NWFP needs urgently to increase employment and wages. This will require increasing productivity levels. The key determinant of GDP per capita among countries is their level of labor productivity. Higher levels of output per employee enable higher wages. In developing countries, manufacturing typically entails far higher productivity levels than either agriculture or services, but in the NWFP only 7.3 percent of workers are employed in manufacturing. Furthermore, the productivity of firms in the NWFP is low relative to international comparators, and relative to other Pakistani provinces. The Investment Climate Assessment revealed that Pakistan as a whole lags China and India in total factor productivity by over 40 and 20 percent, respectively. Relative to China, India and Bangladesh, value added per worker is lower, sales growth is slower, the rate of net fixed capital investment is lower, and as a result, the private sector's contribution to poverty reduction is lower. The need for reform is urgent.

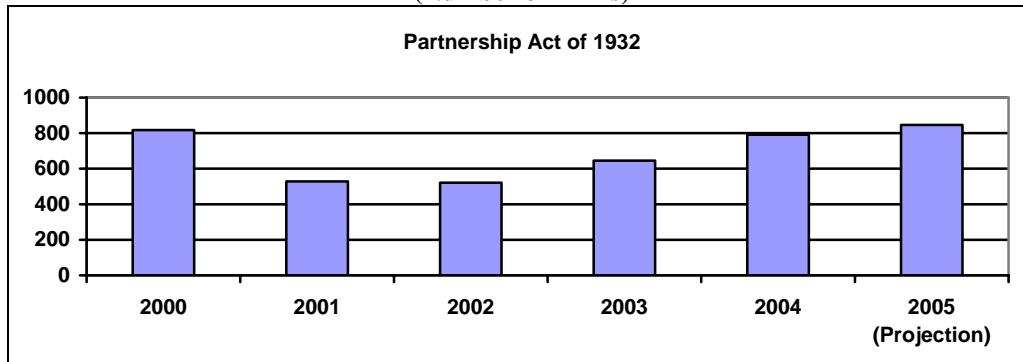
3.3 This chapter identifies some of the major policies that the Government of the NWFP must improve in order to increase opportunities for private-led growth in the province. Increases in growth and income can come from increases in productivity and in investment. A key lesson of international experience is that investors' decisions to invest "depend largely on the way government policies and behaviors shape the investment climate ... the location specific factors that shape the opportunities and incentives for firms to invest productively, create jobs and expand."⁵¹ The chapter focuses on identifying policy obstacles to increased investment and productivity.

3.4 **As was noted in Chapter 1, the bulk of the economic growth and employment generation will have to come in urban areas.** In order to stimulate the growth process, an effort in making the NWFP cities - where trade, commerce, manufacturing, and services are predominantly located - work better would also be needed, by developing policies and strategies focusing on tapping their economic potential and turning them into engines of growth. Section E of this chapter looks at issues in tapping the growth potential of urban centers in the province.

3.5 Should the government adopt a policy program that improves the investment climate, the potential for private sector development in the NWFP is significant. The number of new firms registering has increased each year since the recovery of 2002. Currently, over 800 new firms register per year with the provincial government (Partnership Act of 1932). Significant growth has emerged in the light engineering, construction, retail trade and transport sectors.

⁵¹ *World Development Report 2005: A Better Investment Climate for Everyone*. (Washington, DC: World Bank, 2004).

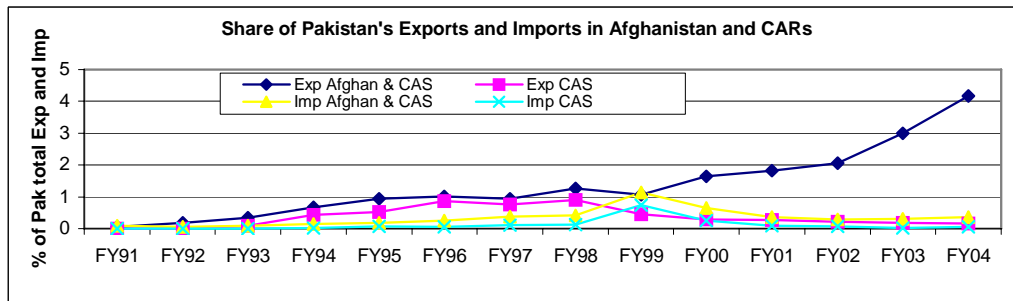
**Figure 3.1: Annual Firm Registration in NWFP, 2000-2005
(Number of Firms)**



Source: Government of the NWFP.

➤ *Opportunities for regional trade are expanding.* Afghanistan is emerging from its period of conflict, and its Ministry of Economy recently predicted 11 percent growth for 2005. Some of the more important growth sectors for investment predicted include construction and electricity. From Pakistan’s standpoint, as one of two main trade partners for Afghanistan, this presents both a trade and an investment opportunity. The share of Pakistan’s exports that go to Afghanistan has risen rapidly from 0.2 percent in 2000 to nearly 4 percent in 2004, or nearly \$500 million. The average annual growth rate in this period was 61 percent. In the last three years, imports have doubled to \$47 million in 2004. Moreover, there has been sizable informal trade between Pakistan and Afghanistan—by some estimates 4-5 times the formal trade. Current indications are that this informal trade has also been growing rapidly.⁵² Growth in trade with Afghanistan opens up potential avenues for trade with the entire Central Asian region.

**Figure 3.2: Pakistan’s Exports & Imports with Afghanistan and Central Asian Republics
1990/91-2003/04**



Source: Government of the NWFP.

➤ *The present growth in the economy and the projection for development in the future has created a huge demand for construction services* from both the public and private sectors. There are 925 construction firms registered in the NWFP, comprising some 9.29 percent of total employment. The federal government has approved a budgetary allocation of Rs 2,080 billion for infrastructure development over the next five years (2005-2010) and is planning additional projects including District Development programs and schemes for the Karachi Port Trust, Pakistan Steel, Port Qasim Authority and the Gawadar port. The total public-sector market for construction is

⁵² The Afghan Transit Trade facility is an important, though not the only, source through which informal trade takes place between Pakistan and Afghanistan. Transit goods from Pakistani ports are sealed and sent to Afghanistan of which an estimated 85-90 percent of the value of Afghan Transit Trade leaks back, largely via NWFP. The Afghan Transit Trade has also expanded rapidly from US\$220 million in FY02 to about US\$370 million in FY05.

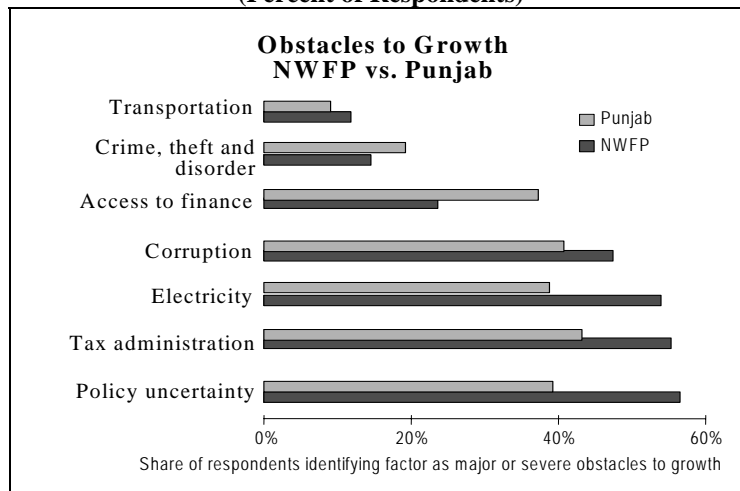
estimated to be Rs 2,500 billion. This will create demand for construction labor from the NWFP as workers from the province enjoy a wage premium throughout the country.

- *The NWFP has substantial mineral resource wealth*, and opportunities for private investment, in gemstones (primarily topaz, also including emerald), precious metals including gold, dimensional stones including marble and granite, and a number of industrial materials including feldspar, phosphates, coal, rock salt, chromites, and silica.
- *The hydropower generation potential in the NWFP is large* and most of the existing major hydel stations (Tarbela, Warsak, Dargai and Malakand) are located in the province, connected to the national grid and are operated by the Pakistan Water and Power Development Authority (WAPDA). Out of 6,595 MW of installed capacity of hydel plants in Pakistan, 3,767 MW of existing plants are located in NWFP. The Sarhad Hydel Development Organization (SHYDO) has identified hydel potential of more than 6,500 MW and has completed feasibility studies of several hydel projects ranging from 8 MW to 125 MW.
- *The NWFP is the richest in tourism assets amongst all the provinces of Pakistan*. It possesses three-fourths of the country's potential tourist assets with sites representing cultural heritage of historical and religious significance, as well as natural, scenic beauty. These significant assets present opportunities to build a tourism industry focused in the short run on domestic tourists, and in the long run on visitors from Asian countries such as Japan, China and Korea who are drawn to explore the historical roots of Buddhism. Similarly the city of Peshawar was founded over 2,000 years ago; its Walled City still boasts of a concentration of historic urban fabric as well as individual buildings and monuments with significant potential for cultural tourism.

B. IMPROVING THE INVESTMENT CLIMATE

3.6 While a number of the policies that affect the investment climate fall under the remit of the central government, many of the issues facing the private sector in the NWFP are those in which provincial authorities must take the lead. The methodology for illustrating areas where the NWFP should act is through comparing the NWFP with better-performing Provinces. As indicated in Figure 3.3, the recent Investment Climate Survey highlighted a number of areas where the NWFP lags behind the Punjab. These include the lingering impact of regional instability, high administrative barriers, particularly tax administration, transportation and corruption. Underlying these perceptions is the state's role as an economic operator in competition with the private sector, sector governance and weak property rights.

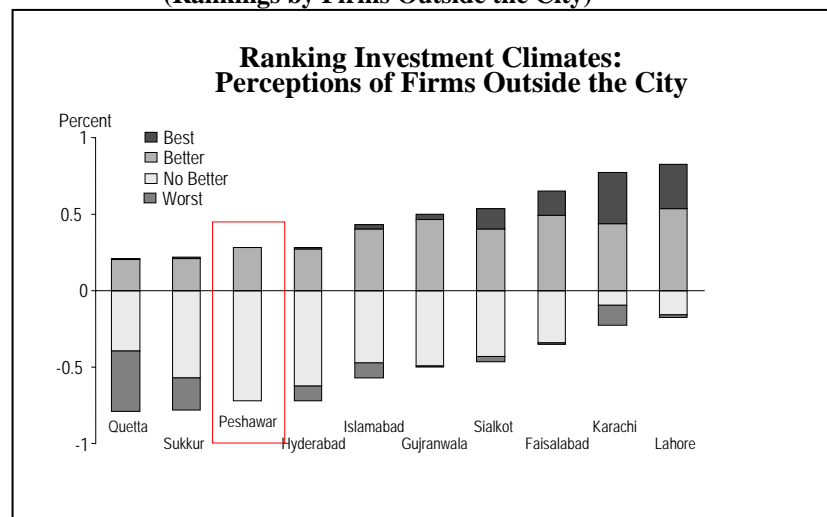
**Figure 3.3: Obstacles to Growth in NWFP compared with the Punjab, 2004
(Percent of Respondents)**



Source: Investment Climate Survey.

3.7 These issues contribute to the perception among investors that Peshawar is one of the least attractive cities to invest, as ranked by firms outside of Peshawar (see Figure 3.4).

**Figure 3.4: Perceptions of the Investment Climate, 2004
(Rankings by Firms Outside the City)**



Source: Investment Climate Survey.

Repositioning the State to Empower Markets

3.8 A key challenge for policymakers will be to gradually withdraw from roles that are in direct competition with the private sector. In contrast to the government's stated policy of involving the private sector in activities traditionally ascribed to the public sector, the Government is involved in many activities that have long been privatized in other developing countries, ranging from financial services to transport and construction. The state, through the National Logistics Cell, a military company, is a large third-party logistics provider. A state-owned bank, the Bank of Khyber, is the largest bank. The largest industrial estate, SDA, is state managed. Some industrial estates have been privatized, but the policy has only been applied as a form of loss mitigation rather than as a matter of principle. Similarly, it is not at all

clear why the NWFP needs to retain state ownership in other areas such as tourism (parks, motels and cable cars).

3.9 In part, the legacy of state ownership is a national issue. The Pakistan Industrial Development Corporation was tasked with the industrialization of lagging regions. In the NWFP it invested in a number of fields, including sugar, paper, biogas, fertilizer and textiles. Most of these sectors are now primarily private. But the existence of any state firm in a sector has the effect of tilting the playing field and discouraging private investors who may be concerned about competitors who may have more privileged access to public resources (including land, licenses, utilities), lack hard budget constraints or have superior capacity to resolve disputes and enforce commitments. The SDA has, for example, attempted to sell some of its industrial estates while maintaining larger, more successful ones. SDA management readily admits that being in the public sector makes the very difficult task of obtaining land, resolving land disputes, and obtaining utility connections — core processes for an industrial estate — vastly easier. Under such circumstances, it would be extremely difficult for private operators to compete with the level of services provided by the state, and are understandably not expressing great interest in the assets. But this not only undermines the competition that will improve services in the long run, it also undermines the ability of the NWFP to attract private estate operators who have been extremely successful in other regions and could play a key role in attracting Foreign Direct Investment (FDI).

3.10 While the role of the state is excessive in areas where the private sector is capable of contributing, the role of the state is insufficient in the provision of essential public goods — particularly in policy and regulatory functions that are necessary to support a competitive private-led growth strategy. Effective governance, in a private sector standpoint, refers to the use of the state's power, policies, institutions and investments in a manner that promotes competition and growth. Well-governed private sectors that have experienced growth are typically governed in a manner that is transparent, predictable and fair. This often requires highly capable, sufficiently rewarded civil servants. In contrast, sector analysis in the NWFP revealed a number of governance issues that prevent fair competition, are less than transparent, or are somewhat unpredictable.

Improving Security

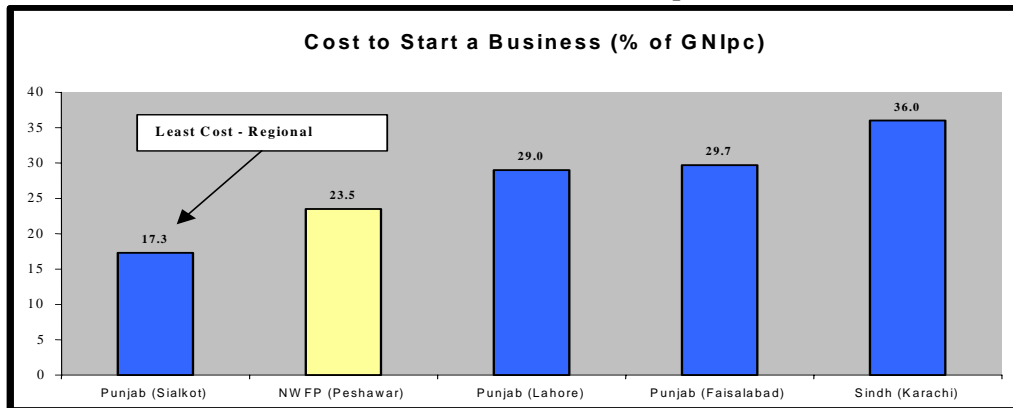
3.11 Improving security is also very important for a better investment climate in the province. The long wars of Afghan liberation, in which the NWFP was the front-line state, created a number of tensions and at the same time flooded the province with arms. There is a lingering perception of regional insecurity, and a number of countries retain warnings or restrictions on travel to the NWFP. The Pakistan Investment Climate survey, on the other hand, indicates that crime and theft are less significant problems in the NWFP than in other provinces of Pakistan.

Reducing Administrative Barriers

3.12 The working of the administrative apparatus needs to be scrutinized and in some important areas made more efficient. Relative to the Punjab, the investment climate in the NWFP was perceived as relatively unfriendly in terms of policy uncertainty, tax administration, electricity shortages, and corruption. Access to finance and the level of crime/theft and disorder were seen as greater obstacles in the NWFP than in the Punjab. Two other issues that are important are taxation and the process of registering a business, in which the record of the NWFP is mixed. There is a recognition however that federal polices play a significant role in the cost of doing business and there is need for harmonization of provincial and federal policies.

3.13 *Business registration.* The process of registering a business, in contrast with tax administration, appears efficient. The 2005 *Doing Business Report* (World Bank) compared registration in the NWFP with other provinces and found that it was relatively efficient — taking only 24 days. It is also relatively low cost compared with the rest of Pakistan, and only Sialkot in the Punjab has a less expensive business registration process.

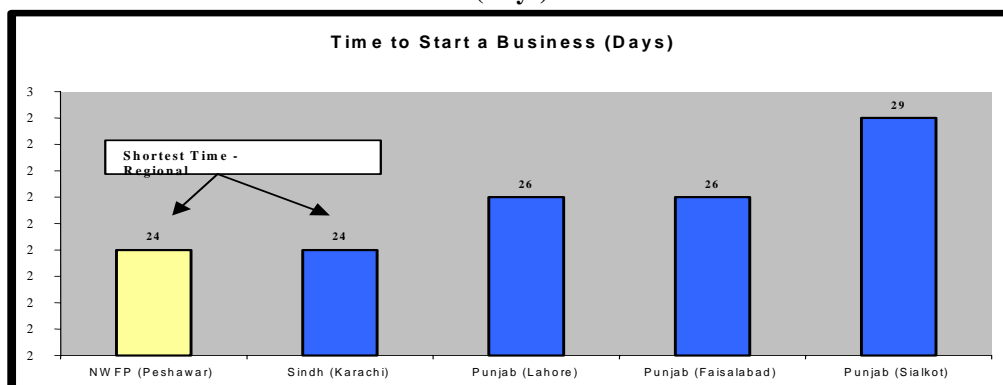
**Figure 3.5: Cost of Starting a Business, 2004
(Percent of GNI Per Capita)**



Source: World Bank/IFC Doing Business Database 2005.

3.14 Despite this relative simplicity, relatively few firms are actually registered. The incentives to formalize in the NWFP do not appear strong, since property rights are weak and access to finance is limited. Formalization of companies is an important contributor to the investment climate, since it enables firms to enter into contractual relationships, strengthens access to finance and allows public policy to be made more accurately.

**Figure 3.6: Time to Start a Business, 2004
(Days)**



Source: World Bank/IFC Doing Business Database 2005.

3.15 *Tax administration.* While entry regulations are not a significant obstacle, the World Bank Investment Climate Assessment indicates that taxation is among the most serious obstacles to growth. Despite past measures, firms in the NWFP face a punishing array of taxes, mostly federal in nature, that make it entirely understandable why so many firms choose to remain informal and why the tax base is so low. Compared with a typical range of 3-4 taxes in more competitive East Asian countries (a VAT in the

range of 10 percent, a social security tax or provident fund of 3 percent, property taxes and an income tax of 20-25 percent) for a typical hotel in the tourism industry, the following taxes are imposed:⁵³

Table 3.1: Taxes Imposed on a Typical Business, 2005

Tax	Rate / Explanation
Sales Tax	15 percent of gross receipts
Property Tax	20 percent of assessed value of property
Income Tax	Approximately 15 percent of pre-tax profit depending on income bracket
Import Duties	As required for imported supplies
Professional Tax	Professional tax is a yearly tax and is paid just for existence irrespective of paid up capital or turnover in smaller companies. The scale goes up with the increase in these two. It may range from Rs 5,000/- to 100,000/- depending on the province of registration and other criteria.
Social Security	7 percent of wages up to Rs 3,000 per month. This is a provincial tax on employers, incorporated or not.
Workers' Welfare Fund	The workers welfare fund at 2.5 percent is charged at the time of the income tax assessment by the income tax department.
Workers' Children (Education) Ordinance	Provincial tax of one hundred rupees per worker per annum, used for providing free education to two children of every worker.
Employees Old-Age Benefits	From 1st day of July 2001, an insured person is required to pay his personal contribution at the rate of Rs 20 per month.

Source: Government of the NWFP.

Increasing Infrastructure Service Delivery

3.16 Inadequate infrastructure inhibits private sector development in the province. The main deficiencies in infrastructure identified by the private sector were the road network (see Box 3.1 for the links to economic growth and a more detailed discussion in Chapter 4), and the delays in obtaining and the price paid for an often unreliable power supply. Transportation costs are a higher share of delivered costs for products originating in NWFP. An example is provided by the transport costs for marble. Figure 3.7 shows the cost of transportation as a percentage of the total cost of the production of marble and related stones, comparing 4 countries. Pakistan has the highest percentage cost for several reasons: i) the mines and processors analyzed for this report are in the NWFP, which is 1,300 kilometers from the port in Karachi; ii) the roads along this route are in generally poor condition, as are many of the trucks; iii) a number of special payments and fees are required to move the block stone from the mining areas to the processors, increasing transport costs.

3.17 Manufacturing industries in the province currently do not get reliable and high quality infrastructure services (power, basic utilities, telecommunications, drainage and sanitation, effluent treatment, quick access to banking services and transportation networks) that are necessary inputs for their production. This adds to their costs and hurts their competitiveness. The province needs to have a framework in place that ensures reliable, cost effective provision of high quality infrastructure services to industries at full cost recovery. This would entail efficiently run industrial estates with private sector management, and joint public-private ventures with the objective of eventually privatizing industrial estate development.

⁵³ Most of these taxes would be common to all businesses or would vary slightly. An accounting firm would most likely lease its premises and not pay a property tax, but would pay a Professional Tax.

3.18 The availability of good roads is also important for tourism. The development of roads and their maintenance in the tourist destination areas, the provision of land at non-commercial rates, the supply of water and power and the development of telecommunication facilities is vital to the development and promotion of tourism. The infrastructure needs have not been taken into account seriously by the government. The STC and the department of tourism have not coordinated with the relevant departments to undertake the task of providing the infrastructure. In the absence of these basic requisites private sector initiative did not grow.

Box 3.1: Rural Road Investment, Poverty and Growth

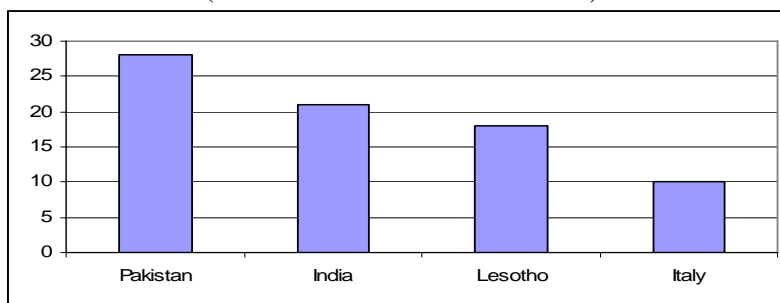
There is a considerable body of evidence that demonstrates the links between rural road investment, poverty and growth. In India for example,¹ in an empirical study of 85 randomly drawn districts, it was found that road investment contributed directly to the growth to agriculture output, increased use of fertilizer, and commercial bank expansion. Another recent study in India using state-level data over two decades on the effectiveness of various government expenditures found that government spending on rural roads had the largest impact on rural poverty as well as a significant impact on productivity growth. Similarly, a study in Madagascar² found significantly higher productivity and crop yields for three major staple items in non-isolated relative to isolated areas. Finally, a case study of accessibility in Sumatra³ found that households in more remote rural villages average appreciably lower levels of expenditures, and when isolated from sub regional market and trade centers, consumption levels fall dramatically. It also showed that the average value of farm produce increases with road quality, frequency of bus service, and close proximity of commercial centers. The same study found that off-farm earnings increase when migrant households have access to both motorcycles and bicycles.

¹ World Bank, 2002.

² Stifel et.al., 2003.

³ Cervera, 1990.

**Figure 3.7: Cost of Transporting Marble, 2004
(Percent of Total Production Cost)**



Source: Global Development Solutions, LLC; American University of Cairo; *Stone World*.

Increasing Access to Finance

3.19 Well-functioning financial markets help mobilize savings and allocate resources to the most efficient firms, thereby enabling their growth. In NWFP, the banking sector is one of the few formal sources of finance (with most of the commercial banks having operations in the province) since there is no equity or bond market, and one of the few local ways of storing savings outside of real property. In Pakistan as a whole over 37 percent of firms reported major or severe problems obtaining access to finance. The World Bank has found that a lack of access to credit has significantly reduced farm-level productivity in Pakistan, and small and rural firms in the NWFP report significant difficulties obtaining access to credit. The lack of access to finance is not a result of a lack of available savings to lend. As of June 30, 2004, lending (advances) by the Bank of Khyber represented only Rs 6 billion of its Rs 20.8

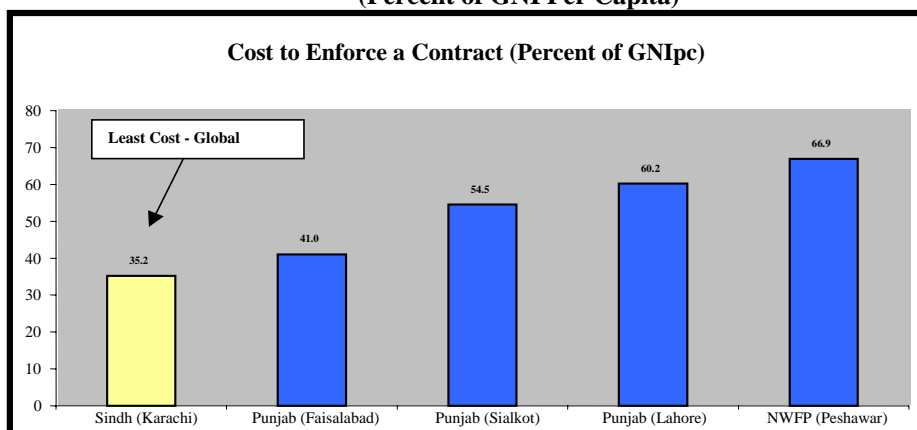
billion balance sheet, with a nearly equal amount in cash or liquid investments. Rather, there is lack of awareness amongst potential clients on requirements for gaining access to finance.

3.20 The mortgage to GDP ratio in Pakistan is only 0.5 percent compared to 2 percent for India and 15-20 percent for South East Asian countries. The penetration level of mortgages is miniscule when compared with the shortage of housing units and the mortgage market is fragmented with the unorganized sector playing a dominant role. Sweeping fiscal incentives have been introduced in the federal budget 2003/04 to encourage mortgage finance. Current macro-economic conditions such as reduced government borrowings, increased liquidity, and rising inflows from foreign remittances have encouraged a low interest rate regime and banks are actively looking at alternate lending opportunities. Total formal mortgage lending is estimated to be Rs 22 billion. A number of specialized development finance institutions serve niche markets such as Small and Medium-sized Enterprises (SMEs). This limits the ability of the private sector to enter these niche markets profitably. The market is dominated by the House Building Finance Corporation (HBFC), a public sector housing finance company with 82 percent market share and direct funding by the state bank of Pakistan.

3.21 Lending to the construction sector is low and considered high-risk because of a general propensity to delays in project receivables and instances of clients canceling projects after commencement and contractors abandoning loss making contracts. Private banks and leasing institutions service the construction industry but the sector is perceived to be highly politicized and its credibility compromised by a wide-spread culture of unofficial payments and commissions. Credit requirements are stringent and the use of construction finance is limited to large contractors with access to abundant fixed collateral. Limited access to financial facilities limits the capability of small and medium-sized construction companies to post bid and performance bonds and acquire capital equipment access. This prevents them from competing effectively and affects growth.

3.22 Contributing to the inability of the banking sector to lend is the high cost of enforcing contracts. The World Bank study, *2005 Doing Business*, found that the cost in the NWFP relative to per capita national income, was the highest of all the provinces of Pakistan, and almost twice that of the most efficient province. Indeed, the burden would appear even heavier if the comparison were performed using the per capita income of the province.

**Figure 3.8: Cost of Enforcing a Contract, 2004
(Percent of GNI Per Capita)**



Source: World Bank/IFC Doing Business Database 2005.

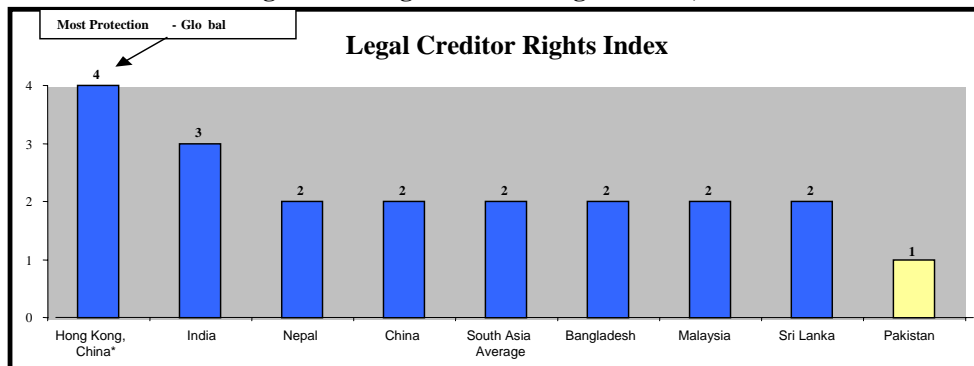
Strengthening Property Rights

3.23 An institutional weakness that stunts the ability of the private sector to make its due contribution to development is the poor documentation and weak enforcement of property rights. Property rights are those rights that confer on their holders the right to use, enjoy or claim an asset within the framework of the law. This entails either outright ownership or use rights that are contractually conferred, such as a lease. Strong property rights give investors the confidence they need to undertake long-term investments, to protect and make improvements to the asset to ensure sustainability of its use. When such rights are assignable or transferable, the underlying asset can be used to pledge as collateral since it can be marketed or sold to repay loans that are in default. When property rights are not secure, investors typically engage in short-term profit taking with a minimum of capital investment.

3.24 The ambiguity of property rights leads to aberrant behavior in many activities in which the NWFP possesses a considerable growth potential. For example, because most of the province's quality marble mines are in FATA, where there is arbitrary, extra-legal enforcement of property rights on much of the land suitable for mining, the industry uses low-yield, uncontrolled blasting to extract marble. This wastes as much as 90 percent of the marble, and produces blocks that are much smaller than required in the international marketplace. Figures 3.8 to 3.10 display some indicators of weak contractual and property rights.

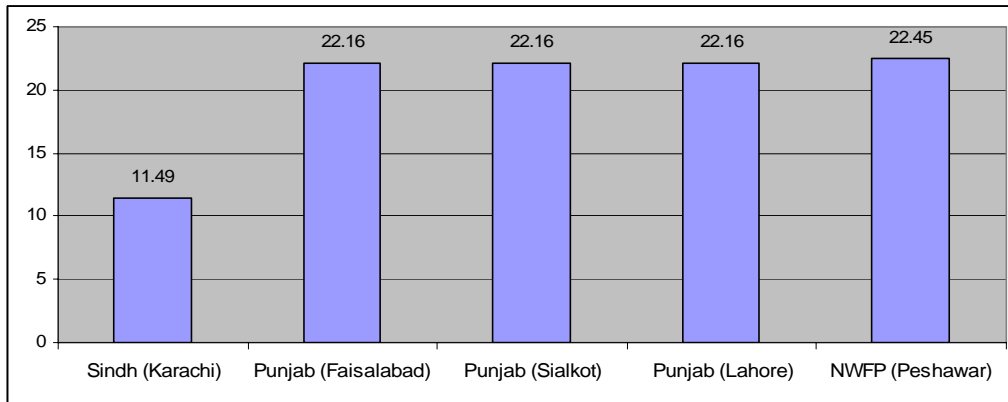
3.25 Weaknesses in property rights also impact with particular severity on the financial sector. Without security, commercial banks lend little beyond short-term, self-liquidating trade finance, thereby leaving a gap in provision of medium-to-long-term funding. Two governance issues seem to be at play. First, there are a large number of development finance institutions (DFIs) which may have originally served to catalyze growth of an underserved segment but now effectively crowd out development of private solutions. These come in addition to the state ownership of Bank of Khyber. The second issue is a legal regime for secured lending that is characterized by lengthy processes of obtaining a judgment to execute on a collateral pledge, due to excessive avenues for appeal relative to well-functioning secured lending systems. The uncertain collection period and potentially high time and court fees undermines the value of any collateral pledge and effectively makes all lending unsecured. Furthermore, as is well known, the titling system in rural Pakistan is ineffective, and rural property is not accepted as collateral by commercial banks.

Figure 3.9: Legal Creditor Rights Index, 2004



Source: World Bank/IFC Doing Business Database 2005.

**Figure 3.10: Costs of Creating a Collateral Agreement, 2004
(Percent of Secured Property)**



Source: World Bank/IFC Doing Business Database 2005.

Improving Land Markets

3.26 The efficient functioning of land markets plays a key role in an economy, particularly that of urban areas. Realizing the growth potential of urban centers in the NWFP will require addressing the factors that currently impede the development of an enabling environment for efficient management of urban land.⁵⁴

3.27 The high and rising price of land raises the cost of doing business in the province and acts as a disincentive to investment. Urban land markets in the province are inefficient and with rigidities that limit supply of land. A more efficient urban land market will enable more effective economic and social use of land and improve its supply for development

3.28 The most formidable constraint to the efficient functioning of land markets in Peshawar is the failure of urban land management systems in establishing ownership in urban properties. The system of maintenance of land records is riddled with ambiguity and multiplicity of authorities, with each agency trying to absolve itself of the responsibility and with its own systems and procedures for determining title or regulating property transactions. Not only are there overlapping responsibilities and a high degree of duplication of information, there is also limited cooperation and interaction between the different agencies maintaining the databases and records of rights in land. Resultantly, there is mismatch between the property ownership/rights to land records maintained by various agencies and there are multiple documents that can be construed as evidence of ownership. Determining title to property with any degree of certitude can therefore take a fair amount of time and investigation. In fact the inadequacies of the legal framework and procedures frequently lead to costly and lengthy civil litigation. This deters the development of a large number of properties of prime commercial value and slows local economic growth.

3.29 The lack of secure property rights also undermines the effectiveness of land being used as collateral in accessing credit. In most cases the property currently represents “dead capital”. A key factor constraining the efficient functioning of land markets is the slow colonization of the housing schemes, even when all associated infrastructure has been provided. As a result, not only is the investment on municipal services being under-utilized, the assets created deteriorate due to lack of use. Raising the non-

⁵⁴ This section is based on a study of urban land markets in Peshawar but the findings are of relevance also for other urban centers.

utilization fees on plots lying vacant could discourage speculation, encourage colonization, and release developed land for productive use.

Increasing Access to Skilled Personnel

3.30 With a population of 20 million and high unemployment, the labor supply in the NWFP is abundant. However, the skills base of the labor force in the province is in general poor and does not meet the needs of a dynamic growing private sector. The average years of schooling in the province is very low and far behind competitor countries as well as behind other provinces. Labor skills demanded by the market frequently do not match those produced by the NWFP's education and training systems. The increasing demand is for middle level managers and for what might be termed "second-tier" mechanical skills, such as those possessed by mechanics, machinists, fitters, and so on. Representatives of the private sector averred that these skills were in short supply and were not being produced in sufficient quantities. According to these representatives, the technical institutions in the province were disproportionately weighted towards the production of fully qualified engineers, for whom the current demand was limited.

3.31 Skill shortages vary by sector. Considered hardworking and, given the right circumstances, more productive than construction labor in other parts of the country, the NWFP labor works for a premium outside the home-province. According to the survey results, both skilled and unskilled labor is easily available although almost 50 percent of the workers are seasonal. An estimated 36 percent of the unemployed workforce in the province has previous construction experience.

3.32 An important element of the province's growth strategy is therefore to increase the availability of skilled labor to meet the future growing demands in the industrial and service sectors. The strategy to develop a more skilled labor force would need to (i) expand the pool of future trainable workers through the ongoing provincial reforms in basic education to raise the average years of schooling and quality of schooling substantially (see Chapter 4 for more detail); (ii) establish and implement a mechanism to assist firms in developing firm-specific skills; and (iii) implement reforms in the provincial higher education system (colleges, through year 14) to improve quality and market-orientation as well as increase the supply of well-qualified students. This would supplement the national strategy for higher education reform at universities and polytechnic schools to enhance the supply of highly-skilled professionals.

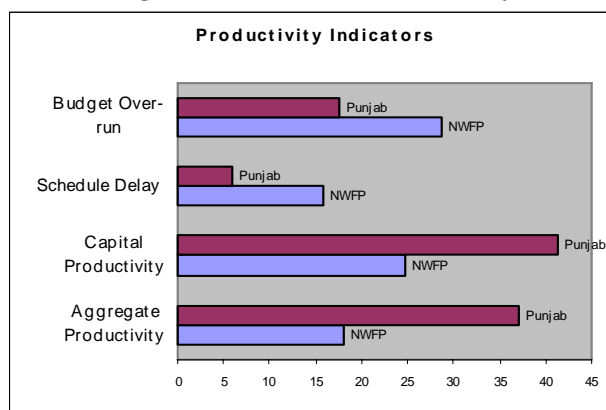
C. IMPROVING PERFORMANCE OF KEY INDUSTRIES: SECTOR GOVERNANCE ISSUES

Construction

3.33 Construction contributes a large share of GDP in both developed and developing economies and has forward and backward linkages to a number of industries. The construction industry in Pakistan however has been ignored to the extent of driving some of the most successful firms in the country to closure. Local firms are also increasingly losing ground to foreign construction companies competing for large public sector projects in the domestic market. The government has taken note of the situation and several budgetary and non-budgetary measures have been instituted recently to revive the industry. As a result, the sector has shown progress in the past two years. Despite price hikes in major material inputs, the sector grew by 7.9 percent in FY04 against a target of 5.4 percent and the market for construction services during the next five years (FYs 06-10) is expected to be Rs 5,145 Billion.

3.34 The construction industry in the NWFP lags behind Punjab's in both Labor Productivity (Aggregate for Brick Housing-Construction and Task productivity) and Capital Productivity. Aggregate labor productivity in the NWFP is almost 50 percent lower than the Punjab while task productivity shows mixed trends; values are high in the NWFP for concreting activities, comparable for girder steel-fixing and masonry and low for slab steel-fixing and shuttering. Capital productivity in the NWFP is low across the board. Other performance indicators for profitability, quality and growth also indicate a better situation in the Punjab where construction companies have grown at twice the rate and execute twice as many projects outside their home province than companies in the NWFP.

Figure 3.11: Construction Industry



Source: World Bank Construction Industry Survey

3.35 Improving the performance of construction companies in the NWFP to the level of firms in more developed parts of Pakistan is hence a crucial first step in realizing the potential of the sector as a key driver of the provincial economy. There are a number of governance issues that prevent fair competition or are less than transparent. The provincial government agencies that regulate and guide the construction sector in the NWFP are also the industry's biggest source of demand. The effectiveness of these organizations is restricted by institutional weaknesses and financial, technical and human resource deficiencies. The key issues in the sector:

- *Weak institutions.* Public sector client organizations are plagued by regulatory, financial, technical and human resource deficiencies. The Department of Works and Services manages 60 percent of the NWFP Annual Development Budget, but has not been able to attract a qualified engineer into the department since 1995 due to low compensation levels.
- *Inadequate contract management and administration.* There are no set procedures for contract management and administration, which may result in discretionary and arbitrary changes in process and thereby distort competition. Financial management problems, including the lack of mobilization advances, funds for works in process, and payment delays are common.
- *Inefficient procurement policies.* The procurement of services is affected by inaccurate project costing, restrictive contractor registration and pre-qualification procedures, collusion and underbidding, and contractual issues. According to a survey conducted for this report, the contractor registration process in the NWFP and a lack of fairness and transparency in the pre-qualification process are identified as major issues and obstacles to growth in the sector. In addition most public sector clients use outdated Schedules of Rates to set prices and assess the cost of a project. The actual costs during execution are much higher than anticipated by clients and the terms of the contract usually leave the contractor liable for cost over-runs. Inaccurate project costing using obsolete Schedules of Rates, overlapping contractor registration, unstandardized processes and lack of transparency contribute to a lack of fair competition and ultimately substandard work.
- *Lack of standardization of contract documents and registration.* Although procurement rules have been formulated (PEC's Standard Bidding Documents) these have adopted the weaknesses manifest in the existing procurement system and do not attempt to make the procurement cycle

fair, balanced, efficient and market oriented. Moreover, most of the relevant public servants are not aware of these rules and continue to use their own contracts. Public sector clients also enforce unique registration systems that duplicate the purpose and functionality of the PEC License. About 67 percent of all respondents identified the registration system as a major obstacle. The terms of most of these departmental contracts are flawed and give the client an unfair advantage, entirely overlooking the interest of the contractor. Escalation and arbitration for instance are not accommodated as a rule and arbitration initiated by a contractor leads to almost immediate black-listing of the company by all public sector clients. Contract enforcement is also weak and deviations from contracts occur frequently.

- *High Unofficial costs.* Unofficial costs, including ‘acceptance money’, commission on payments and fudging of quantities and work during execution originate from inadequate compensation in client departments, systemic weaknesses and lack of accountability.

Hydroelectric Power

3.36 As previously described, the NWFP is blessed with significant hydroelectric potential, and therefore the considerable advantage of being able to base its growth on a renewable, environmentally friendly energy source. To promote this resource, the provincial government announced a Hydel policy for small-scale plants (up to 20 MW), which is currently being revised. Notwithstanding this policy, however, there may still be lack of understanding among potential investors on different issues such as tariff, identity of the buyer, guarantees, lease price and transfer of sites at the end of concession period.

3.37 Hydro plants with installed capacity less than 50 MW do not come under the purview of the Private Power and Infrastructure Board (PPIB) – the federal government’s facilitation agency for private investments in the power sector. The role of National Electric Power Regulatory Authority (NEPRA) in the regulation of power sector is also clearly established through the law, rules and regulations. Investor confidence may, however, have been affected by inconsistent application of the policies, rules and regulations. For example, previously, Malakand III was initially offered by the Government of the NWFP to private investors but was withdrawn and implemented in the public sector. Such policy reversals undermine the confidence of private sector that shy away from investing in feasibility studies for prospective sites as these investors are not certain about future policy decisions of the government. Lack of consistent implementation on policy issues, high hidden costs in setting up business in the NWFP and bureaucratic procedures have also been cited as the main problems experienced by private sector in setting up hydel plants with capacity below 50 MW. Unlike Azad Jammu and Kashmir (AJK) which has successfully attracted private sector interest as two plants are already under implementation, such interest from the private sector has been missing in the case of the NWFP despite far greater economic potential. Delay in setting up of Matiltan, a private sector project in NWFP, due to its on-going dispute with WAPDA is not an encouraging example either for the private sector.

3.38 Development of wheeling charges has the potential of opening up the electricity market in the future as generation companies, which in the case of hydel are located in difficult terrain where industrial estates can not be set up, can enter into negotiations with different industrial sites for sale of electricity through the transmission and distribution network of National Transmission and Dispatch Company (NTDC), the main transmission grid company, and distribution companies, respectively. According to NEPRA’s rules and NTDC’s license conditions and approved tariff, wheeling charges from a generation company for transmitting electricity to a desired site through its transmission network are provided for. NEPRA is encouraging generating companies to enter into direct agreement with buyers which can be distribution companies or bulk consumers (industrial sites). In the case of on-grid sales, generation plants have the options of selling electricity to NTDC, Peshawar Electric Supply Company (PESCO) or bulk consumers. In case the plant decides to sell electricity to a bulk consumer within the province, it is

required to pay distribution charges to PESCO for the use of its network for supplying electricity to the desired bulk consumer. In case NTDC's transmission network is also used for transmission to a distribution company, wheeling charges have to be paid to NTDC in addition to distribution charges to the distribution company for delivering electricity to a desired industrial site. The framework is clear, although incorporating the wheeling and distribution charges for delivering electricity may impact the attractiveness of existing plants (such as Malakand III), and also a number of potential future investments, including in plants with capacity below 50 MW. There is a need for consensus and coordination among different stakeholders including investors in generation, provincial government, NEPRA, NTDC, PESCO and representatives of industry and estates on how costs have to be borne.

3.39 For plants below 50 MW, the Sarhad Hydel Development Organization (SHYDO) is fully empowered to facilitate potential investors. For this building policy capacity of SHYDO is required. In the case of off-grid hydel plants being run by SHYDO, bill collection and enforcement is a problem, but this has been substantially improved.

Tourism

3.40 Tourism organizations around the world use policies, investments and institutions to ensure that tourism is managed in a sustainable manner. Tourism has become an extremely important source of jobs in many countries, with international tourism revenues predicted to continue to expand.⁵⁵ The Sarhad Tourism Corporation (STC) was established as a key institution for public private collaboration, safeguarding ecotourism in the province, and establishing tourism facilities in the province. The following key issues in tourism were identified:

- *Government has set out a major role of STC to develop and maintain all necessary tourism related infrastructure in the province.* However, tourism is a highly capital intensive industry and also involves high maintenance costs. It is not possible for STC alone to fund such investments from its own resources, neither is it desirable, and the private sector should be invited for investments. STC should only exercise a monitoring and regulatory role instead of managing and operating the lodging facilities and tourism development projects. Its existing mandate should therefore be revised to reflect these priorities.
- *STC's role in sector governance.* Notwithstanding its economic potential, tourism can have a negative cultural, environmental and social impact if it is not responsibly planned, managed and monitored. STC has not fulfilled its critical role of governance in these areas.
- *A lack of information on which to set strategies and priorities.* The NWFP contains a wealth of cultural and physical assets on which a tourism strategy can be based. There is significant potential for adventure tourism, ecotourism, cultural tourism, and mountain climbing. The sustainable development of each of these requires a different approach and substantial resources. Critical choices will need to be made. However, there is very little accurate data on either the market (tourist arrivals, spending, visits, etc.) or assets as the basis for decisions.
- *Weak interface with state institutions.* Effective governance also requires coordination between agencies that affect tourism, such as the Frontier Highway Authority. Road access is sporadic to some of the key sites, particularly in Chitral, due to the seasonal nature of the Lowari Pass and the

⁵⁵ Tourism in NWFP must be seen as a medium-term prospect. While the regional security situation has improved, travel advisories remain that have contributed to a dramatic decline in tourist arrivals, including 90 percent for Chitral. With continued improvements in security, these advisories will be reassessed.

entry to Swat through the Malakand Pass. Improving the roads in these areas would help in promoting tourism further.

- *Environmental regulation and protection.* Unmanaged tourism development can quickly spoil natural beauty in places such as Swat and Naran-Kaghan. A combination of regulatory standards and awareness using local organizations and NGOs can stem this problem. An example is Hunza where local NGOs have made people aware of the importance of tourism and keeping the local environment clean.
- *A lack of institutional representation of the private sector.* The private sector is a major investor/stakeholder in the travel, tourism and hospitality industry in the NWFP. It owns as much as 90 percent of the industry and specifically hotel and transport sector in the province but is shy to invest in the other major tourism related projects. When the private sector is invited to invest, it faces unnecessary bureaucratic delays and outdated policies and procedures. The private sector does not have any representation in policy making. In the case of the Punjab the Board of Directors of TDCP includes three members from the private sector.
- *A lack of community participation.* It has increasingly become clear that tourism development cannot be sustained without the participation of the local communities. Unfortunately in the NWFP the local community is ignored and is not given the sense of ownership. Lack of community participation and awareness can result in depleted tourism assets, security and safety concerns, polluted and unhygienic living conditions and limited and poor infrastructure. It is therefore commonly recognized that the community plays a significant role in the sustainable success of many projects, either as owner, user or facilitator. Major areas for community participation in tourism development include security, hospitality, human resource and environmental conservation and a host of tourism support services.
- *The absence of promotion.* A comprehensive and integrated campaign both at intensive and extensive scales is an essential prerequisite for the success of the tourism industry. Due to the absence of a Marketing Department, STC has not played an instrumental role for the marketing and promotion of its rich tourism assets and activities something the Provincial Tourism Policy and STC's Memorandum and Articles of Association consider one of its prime responsibilities.

D. CREATING LINKAGES AND DEEPENING SUPPLY CHAINS

3.41 As a result of many of the constraints cited above, the economy lacks linkages between stages of the value chain. Policymakers and the Bank have come to understand that the effectiveness of the private sector depends not only on a conducive enabling environment, but also on how the private sector is organized (including the presence of support institutions) to maximize productivity along the entire chain of activity from raw materials to final goods. Since businesses do not operate in isolation but within networks that include service providers, suppliers and buyers, understanding the characteristics and inefficiencies of specific value chains can be extremely influential in (a) targeting policy interventions more specifically on the areas in the enabling environment which impact the domestic productivity, (b) understanding the linkages between foreign investors and domestic suppliers in order to increase the poverty impact of an open economy, and (c) help policymakers understand regional integration more thoroughly, since domestic producers may actually participate in cross-border supply chains. Value chain analysis follows the product flow and hence cost components in the value chain of the selected commodities from the initial point of production to the final market destination. This identifies and quantifies significant cost disadvantages which can be linked to specific policy distortions and/or administrative and regulatory hurdles. Comparing the findings across several products can provide useful information about cross-cutting constraints to growth.

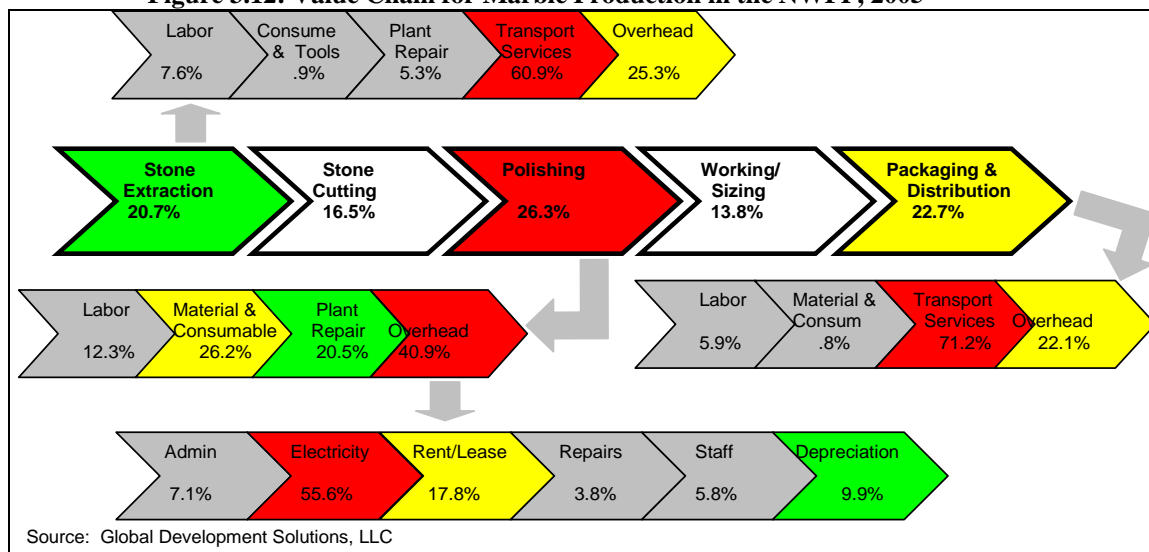
3.42 Integrated value chain analysis (IVCA) in the NWFP was conducted on the marble and apple sectors. According to the IVCA, 26 percent of total costs⁵⁶ in marble production came from polishing, followed by packaging and distribution at 23 percent and stone extraction at 21 percent (second bar in Figure 3.12).⁵⁷ Each stage revealed a number of cross-cutting issues. Poor property rights at the extraction stage create weak incentives to create the type of investment that might increase the yield of high-value blocks. The result is a chain that has excessive transport costs at the extraction stage and extra polishing costs. Entrepreneurs in the marble sector also contend with high electricity costs. Due to the nature of stone extraction and the poor techniques and technology used by industry participants, industrial waste in marble extraction and processing is higher in Pakistan than other major competing countries.

Table 3.2: Percentage of Waste from Marble Mining and Processing, 2003/04

Country	Percent waste in mining	Percent waste in processing	Percent in total waste
Pakistan	>60	>25-35	~90-95
India	30-50	15-25	45-75
Egypt	30-55	15-25	45-80
Jordan	25-55	10-20	35-75
Italy	20-40	5-10	25-50

Sources: Global Development Solutions, LLC; American University of Cairo; *Stone World*.

Figure 3.12: Value Chain for Marble Production in the NWFP, 2005



3.43 In the apple sector, despite having a significant apple crop, there is no apple juice factory in NWFP. The use of middlemen with significant bargaining power decreases the ability of producers to invest in downstream processing activities that might raise the value of locally-produced items. A lack of effective extension services means that farmers are contending with trees that are severely wrought with diseases (codling moth, various fungi, and mites), requiring as many as 10 sprays per season. The result is that farmers in Swat are switching to peach trees because they have fewer diseases to fight (at present),

⁵⁶ This includes return on capital, hence total costs equal sales price.

⁵⁷ In both figures the second, long chain shows the total cost or value addition for the product. The other bars show further cost breakdown of selected cost items to drill down the underlying problem; e.g., in the case of marble production, a very large share of stone extraction cost consists of transportation costs that reflect excessive waste in the mining stage (blasting rocks) that needs to be transported to the site of stone cutting.

although peaches are less profitable than apples. The lack of disease free, rot free, disease resistant root and tree stock has severely decreased apple farm incomes.

3.44 As depicted in Figure 3.13, total apple production costs (second bar) are driven up by factors that operate throughout the value chain, including *high chemical and spraying costs*, high packing material costs and high rental costs for equipment, including a lack of portable grading equipment, and a lack of crop insurance. High *unit costs for electricity* contribute to a lack of investment in cold storage facilities, which might enable pre-cooling and export, as well as a reduction in the estimated 15-20 percent post-harvest losses. As long as supply chains remain fragmented, farmer income will remain low.

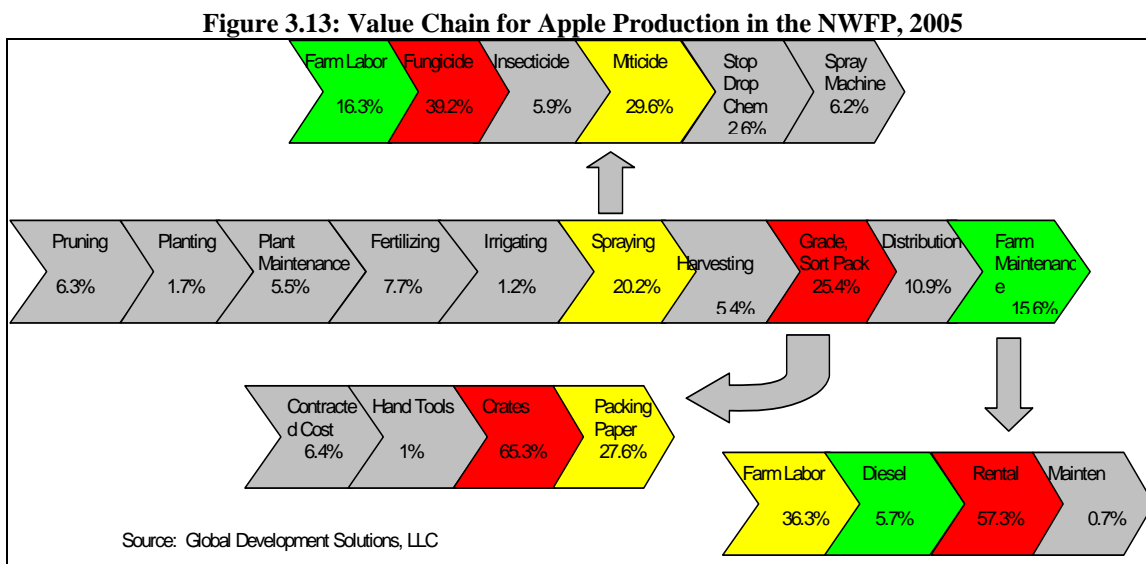


Table 3.3: Summary of Issues Facing Key Industries

	State has ownership/ operational role	Sector policy and institutional / regulatory capacity	Contracting	Property Rights
Construction	State operates Abbassin and a number of other construction companies	Procurement capacity and contract management capacity	Unharmonized, discretionary, slow adoption of FIDIC	High collateral requirements, especially non-urban projects
Tourism	STC owns four hotels, four other properties	No NWFP tourism policy No strategy for engaging with private sector.		Some issues particularly in tribal areas
Marble / Gems		Private Sector Policy exists, but not extended to non-provincial mines.	Issues with managing mining concessions competitively	Surface rent disputes Land titling issues
Hydroelectric Power	Malakand III shifted from private to public sector	Clearer sector policy needed particularly for small hydro projects and for competitive concessions.	Contracting issues: tariff setting, wheeling charges	Rights to use national grid

E. TAPPING THE ECONOMIC POTENTIAL OF CITIES

3.45 The Government of the NWFP needs to invest in developing a vision and strategy on how to turn the cities in the NWFP into engines of economic growth to explore and optimally tap their inherent economic potential. For cities to contribute efficiently to development, they must harness their resources in the direction of their comparative advantage. When appropriately developed, a vision and strategy can assist cities to not only attract investment and corporate business, but also higher income residents. However, to date there has been no effort towards doing so.

3.46 Peshawar is the provincial capital and the largest city in the province with a population of 2.2 million. The devolution of powers in end-2001 resulted in fundamental restructuring of institutions of development planning and urban management. The Municipal Corporation Peshawar (MCP) was abolished and replaced by the City District Government of Peshawar (CDGP) and four autonomous Town Municipal Administrations (TMAs). The Peshawar Development Authority (PDA) was abolished, and the City Development and Municipal Department (CDMD), was created for management of macro-municipal functions at the district level.

3.47 The authorities need to address these key issues:

- There is also an absence of a clear mandate for Local Economic Development (LED). No ministry/department/agency at any level of government has the responsibility to either formulate policies or implementation strategies for maximizing the LED potential of urban areas. Local governments, including the CDGP, only have a limited role in such policy formulation. On the other hand, federal and provincial policies and regulations on for example improving the investment climate or attracting tourism which are to be implemented at the local level, are formulated without involving or taking the views of the local government into account.
- Integrated strategic and action planning, which are a norm internationally, remain absent in the country generally and in the NWFP particularly. Antiquated concepts of Master/Structure Plans are still in vogue. These tend to be land-use plans at best, and take so long to finalize that they are outdated even before they can be implemented. And in cities such as Peshawar that have a recently formulated Master Plan, even the institutional mechanisms for implementing its recommendations remain unclear.
- There are multiple agencies undertaking development activities in the cities. Each of them has its own jurisdiction, development priorities, byelaws, and regulations. There is no coordination between these agencies, and development activities continue on a piecemeal basis. Uncoordinated investment decisions and fragmentation of funds into piecemeal investments lead to sub-optimal use of scarce public resources. Planning at the local level remains limited to annual development plans, which are driven by budget allocations for projects, which in turn are generally prioritized on an ad hoc basis. Excessive fragmentation of funds leads to very small projects that at best have union-level priority with little impact for the city district. Moreover, development allocations are uncoordinated and not based on an integrated development framework with buy-in from all key players. Unfortunately they are made based on political expediencies without correlating their relationship with the city's potential for local economic development; involving stakeholders particularly of the business/trader community to establish investment priorities; or undertaking an analysis of the competitive advantage of the city. Moreover, the timeframe for all development planning is limited to only one year, with no multi-year rolling plans.

- Within the jurisdiction of CDGP, urban management remains weak due to capacity constraints. Effective management of the city of over 2 million requires professional expertise that is not available in the public sector, and hiring from the market remains an issue. The most technically well-endowed agency in Peshawar has been the CDMD. However, it has turned into an implementing agency for major projects, and is at the risk of fast losing its planning capability if its expertise is not put to constructive use. Responsibilities of integrated services like water and sewerage, building regulation, and development control have been devolved to the 4 TMAs, which do not have the capacity to manage them. Indications of severe deterioration in these services are already apparent. Moreover, these services require consistency of policy frameworks and implementation processes, which can only be achieved by retaining them at the district level. For City Districts, this is also in line with the LGO provisions.
- The regulatory framework of Peshawar, including zoning, floor-area ratios (FARs), and building control regulations, is completely outdated, severely restrictive, and far from international standards. Since it does not respond to the market forces, it results in discouraging investments in the city. Moreover, the CDGP, CDMD, and Cantonment Boards each administers its own non-uniform building byelaws with little coordination with the others. Within the CDGP, the enforcement of these regulations has been devolved to the 4 TMAs, which have little capacity to enforce. These factors have given rise to land and building mafias, which are behind the proliferation of katchi abadis and building violations.
- Absence of an enabling environment discourages private sector participation, particularly for commercially viable services like water supply, transport, or solid waste management.

As a result of the above factors, the coverage and quality of infrastructure and services is worsening while the population of the city continues to increase at a rapid pace.

F. RECOMMENDATIONS

3.48 The private sector in the NWFP must be developed on a new foundation of governance that builds on macroeconomic stability with low entry barriers, a clearly defined role of the state, and the rule of law. The development of regulatory frameworks that promote competition and transparency for a large number of sectors is within the scope of provincial authority. Such a foundation can lead to the desired outcomes of its private sector vision — a larger formal sector, higher levels of productivity, higher value employment, and therefore poverty reduction.

3.49 Any strategy must go beyond vision; it must involve strategic choice. A strategic shift toward private sector development will not occur unless the government makes a concerted effort to reposition the role of the state, radically reduce the administrative burden on firms in order to encourage formalization and increase the tax base. Beyond this, the Government of the NWFP needs to make reform a continuous process. Most importantly, relationships of mutual trust and respect need to develop between these three stakeholders in line with the true spirit of private sector development and local governance. The focus of reform should be on:

- strengthening the capacity of the government to execute public-private partnerships;
- repositioning the role of the state away from operational roles (such as exist in tourism, construction, logistics and banking) and toward the provision of effective sector regulation;
- enhancing property rights, clearly defining jurisdiction and enforcement in PATA;

- strengthening sector governance;
- focusing on selected infrastructure improvements, such as cold storage and logistics; and
- streamlining tax administration and other administrative barriers for all enterprises (rather than creating fiscal incentives).

These are elaborated below.

3.50 Strengthening public-private dialogue. This report recommends that the public-private sector committees that exist on paper set up a regular schedule of meetings to which they rigorously adhere (it appears that many of these committees have not met for periods of up to two years). At the same time, an umbrella Government-Private Sector Forum modeled after similar fora operating in many of the East Asian countries can be established (see Box 3.2).

3.51 Recent PSD Policy Changes. It should be noted that in the spring of 2005 there has been a substantial shift in the orientation of the government towards the private sector as reflected in concrete actions and several of the recommendations that the joint Bank-Government team had been discussing in the preparation of this report have been implemented. Recent measures include:

- Establishment of an Investor Facilitation Council under the chairmanship of the Chief Minister and an Investor Facilitation Committee with the Chief Secretary as chairman. Both high level committees have equal representation by the private and the public sector.
- Handing over of management of Industrial Estates to the private sector.
- Establishment of Central Management Committees to govern public technical schools and vocational training centers. There is equal representation by the private and the public sector and the Chairperson is from the private sector.
- Drafting of new concession rules for mining addressing deficiencies mentioned in this report.
- Exemption from labor inspection after compliance with labor laws thus reducing government interface.

3.52 The critical challenge remains sustained implementation of these steps to ensure that the initiatives are effective in facilitating PSD. Though the government has taken the important decision of partnering with the private sector it is now a joint responsibility of both sides to showcase cooperation to continue to refine the province's strategy for PSD and economic growth.

Box 3.2: Three Examples of Fora for Private-Public Dialogue

These examples are taken from the World Bank, *The East Asian Miracle — Economic Growth and Public Policy*. Oxford: Oxford University Press, 1993.

1. Japan: "Japan's efforts to establish fora for public-private dialogue are the most widely recognized and had been the most thorough. Since the beginning of the post-war period, the Japanese government and private industry had engaged in serious policy deliberations through *deliberation councils* of two types. The first is organized along functional or thematic lines, the second is organized according to industry. Each council provides a forum of government officials and representatives from the private sector-business, labor, consumers, academia, and the press in order to discuss policy and market trends and generally to exchange information. Consensus is encouraged. [A showcase example is] the process of formulating a policy at the Ministry of Trade and Industry (MITI). MITI officials first invite interested parties to a series of hearings, the results of which are forwarded to a MITI research group. The research group prepares a report for the appropriate deliberative council, where policy negotiations may take place. On the basis of feedback from the council, the group revises the report and releases it to the public explain the objectives of the new policy. Final approval by the Diet is usually routine. Without consensus from the relevant deliberative council, however, a MITI policy stands little chance of success" (pp. 181-2).

2. Singapore: "Public-private consultation is most explicit in Singapore. The private sector participates in policymaking in many ways. For example, private citizens serve as directors on government statutory boards and as members of *ad hoc* government advisory committees. In both capacities, they review policies and programs and make recommendations for official consideration. In addition, the government regularly invites chambers of commerce, trade associations, and professional societies to submit their views on specific issues."... The Singapore government's efforts to manage the economy are most fully apparent in the National Wages Council, which includes representatives from government, business, and labor. Because of this tripartite structure, the NWC fulfils several coordination functions, simultaneously furthering the government's guidance of business and of labor, as well as business-labor cooperation" (p. 184).

3. Malaysia: "Malaysia's experience with public-private cooperation through deliberative councils has particular relevance for developing economies. Unlike Japan..., Malaysia is a multi-ethnic society, and unlike Singapore it has a relatively large population and land area. Thus Malaysia is in many ways more typical of a developing economy than are the high-performing economies of North-East Asia. ... In Malaysia, officials have applied this concept to their quest for growth with equity, a particularly important goal in a multi-ethnic society. ... [The deliberative councils] would be hamstrung without an efficient and reputable civil service bureaucracy. The government recognizes this and is trying to increase the bureaucracy's efficiency, eliminate corruption, and educate civil servants on the value of cooperating with the private sector" (pp. 186-7).

Infrastructure Services

3.53 Ensure reliable, cost effective provision of high quality infrastructure services to manufacturing industries at full cost recovery:

- run industrial estates with private sector management
- establish joint public-private ventures to introduce private industrial estate development

Improving Land Markets

3.54 *The most important requirement to make the land markets function optimally is a system that determines title conclusively.* There is a need to consolidate title determining responsibility with one department. A centralized land registry system in the form of a central register of land title should be

established with one central agency. The Excise and Taxation (E&T) Department is the best candidate as it has the most complete and accurate record of urban properties in the province, and is most suited to fulfill this exclusive mandate to determine title. Furthermore, there should be no overlapping jurisdictions. Thus in areas brought within the ambit of urban immovable property tax, revenue authorities and *patwaris* should be required to not maintain parallel records of ownership.

3.55 The empowerment of the E&T Department can only be a long-term goal. In the meantime, the government should: (a) update the existing records, especially of vacant land, of the other departments involved in administering urban land; (b) ensure that all future transactions are through registered documents; (c) computerize the Registrar's Department so the electronically based land registration system can produce a property index register relating to all transactions in a property quickly and in a transparent manner; and (d) lower stamp duties as incentive to register transaction documents.

3.56 *Compulsory Registration of All Transactions Related to Properties is vital.* A system of registering deeds can provide the platform on which a system of registering titles can eventually be built. Hence, the registration of *all* property transaction related documents should be compulsory, and the Registration Act and the Stamp Duty Act should be amended accordingly.

3.57 *Additional reforms that can help improve the utilization of urban land* could be reducing the cost of investment by raising the land non-utilization fee on plots lying vacant and enacting legislation to abolish *benami* holding of property by narrowing further the differential in property tax paid by rented and owner-occupied properties; and revise the Rent Restriction Ordinance to reduce the pro-tenant bias.

3.58 Dispose of land in prime commercial locations owned by the provincial and local governments and used for less productive purposes, or presently leased out to the private sector for a nominal rent. In this regard the NWFP Local Government Ordinance (LGO) 2001, that curbs the local governments from placing their properties to more efficient and productive use, also needs amendment.

Access to Skilled Personnel

3.59 The strategy to develop a more skilled labor force would need to:

- expand the pool of future trainable workers through the ongoing provincial reforms in basic education;
- implement reforms in provincial colleges to improve quality and market-orientation as well as increase the supply of well-qualified students (see Chapter 4 for more detail); and
- establish and implement a mechanism to assist firms in developing firm-specific skills.

Improving Performance in the Construction Industry

3.60 Enable a better business environment and enhance the performance of the private contractors by:

- *Improving Procurement rules.* Procurement rules may be revised to make them fairer and more balanced. Single bid should not be reason for rejection, composite schedule of rates should be replaced by market rates and there should be a system of appeals. Clearer and more detailed consultancy rules should also be formulated and adopted.

- *Improving and standardizing contracts.* Implementing the PEC Standard Bidding Documents across all client agencies and accommodating escalation in the price of construction inputs, arbitration of disputes and payment/billing schedules in the contract terms.
- *Improving the procurement process.* Pre-registration should be abolished; there should be no post bid negotiations. Adjustments to bonding and guarantee requirements according to the guidelines of the PEC.
- *Centralized contractor performance monitoring.* A system to monitor performance of private contractors, defined and pilot tested within a sample of contracts and refined for provincial rollout.
- *Capacity development of public sector clients.* Adequately staffed (right-sized), professionalized and properly equipped departments, with hiring, salary and promotion based primarily on performance and merit. Cost of capacity-building will be realized through savings from reduced escalation and rework of projects.

Improving Performance in the Hydroelectric Power Sector

- Remove inconsistencies between the two policy frameworks of SHYDO and the Pakistan Private Power and Infrastructure Board, respectively.
- Strengthen SHYDO's institutional capability on policy issues and on dealing with domestic and international private investors.

Improving Performance of Tourism

- *Restructure STC.* Revise STC's mandate to reflect that it should only exercise a monitoring and regulatory role instead of managing and operating the lodging facilities and tourism development projects.
- Strengthen STC's capacity for marketing and promotion of tourism in the province.
- Invite the private sector for investments in tourism related infrastructure such as lodging facilities and tourism development projects.
- Include private sector representation in sector policy making, e.g., in STC's Board of Directors.
- Facilitate local community participation in tourism development.

Tapping the Economic Potential of Cities

- **Establish an Apex Steering Committee (SC)** with membership of all stakeholders including MPAs, provincial and local government agencies, Cantonment Boards, utility agencies, Chamber of Commerce, academia, intellectuals, and sector experts; chaired by the Chief Minister. The SC should be responsible for: (a) developing a vision and policy on tapping the economic potential of the cities in the NWFP; (b) ensuring the development of a strategic plan for each city based on them; and (c) providing implementation oversight so that investments undertaken in each city are aligned to the plan. It should also get the requisite authority to mobilize all stakeholders involved to participate in the development decisions of their cities, starting with Peshawar.

- **Establish an Urban Development unit housed in the provincial Planning and Development (P&D) department** to act as the Secretariat for the Steering Committee. A comprehensive vision and policy for urban development in the province require underpinnings in research, experience, and expert technical advice. This unit would therefore need to have close linkages with various institutions that are involved in such pursuits like the proposed Institute of Urban Infrastructure Planning of University of Engineering and Technology (UET), as well as experts and subject specialists. In many countries, Associations of Local Governments have also proved to be an effective vehicle, particularly for experience sharing and capacity building.
- **Develop an Appropriate Structure and Mandate for CDMD.** The CDMD needs to be fundamentally restructured and provided with a mandate to develop integrated strategic and action plans for Peshawar, taking into account local economic opportunities, means to optimally exploit them, existing constraints and how to effectively mitigate them. Simultaneously, there is a need to undertake a functional review of the multiple institutions responsible for urban development & municipal service provision at provincial and local levels in light of experience post-devolution; remove overlaps and gaps, rationalize mandates at appropriate levels, and build appropriate technical and management capacity.
- **Modernize Building Byelaws and Regulations, starting with Peshawar,** to make them at par with international standards, and based on the integrated strategic plan for the city. In their revision, the multiple urban management agencies and key stakeholders must participate, to ensure buy-in and their uniform application and enforcement across the city. It is also crucial that once in place; the new regulations are reviewed, and revised as needed, on a continuous basis to respond to the emerging needs of a growing metropolis. Similarly, the arbitrary restrictions on FARs and heights of buildings need to be reviewed, and be linked to emerging market demands.
- **Ensure that all development funds to be invested in the Peshawar District are based on the integrated strategic and action plans,** developed with the consensus of all stakeholders under the guidance of the Steering Committee.
- **Retain the responsibility of networked municipal service provision, building regulation, and development control at the CDGP level, rather than devolving them to the TMAs.**
- **Encourage private sector participation in municipal service delivery through public-private partnerships** to enhance local government capacity. This would involve: (a) identification of commercially viable services; (b) provision of an enabling environment for private sector participation; and (c) outsourcing delivery and management of identified services to the private sector while retaining oversight on their performance.

3.61 **Initiate an Information, Education, and Communication (IEC) Campaign:** While devolution has delegated responsibility and authority to local levels, it has not been able to influence attitudes and mindsets, a crucial factor for its success. The IEC Campaign should educate local politicians on the authority and the responsibility that the LGO has vested in them; educate the local government bureaucracy on its role as the executive arm of the local government responsible for meeting performance and service delivery targets; and educate the citizens about the voice they have been provided through the LGO to get their needs fulfilled, to hold local governments accountable for the targets they have undertaken to achieve and to minimize politically motivated decisions. But they also need to understand their civic responsibilities of paying taxes and user charges for the services they get.

ANNEX 3.1: PSD: CROSS-SECTORAL RECOMMENDATIONS

Issues Addressed	Results Sought	Steps Needed
1. GOVERNMENT-PRIVATE SECTOR FORUM		
<ul style="list-style-type: none"> ▪ Bureaucracy’s Private Sector Development vision lacks systematic public-private dialogue ▪ Strategies so far have not included good stakeholder analysis; Public sector needs greater understanding of the private sector and its beneficiaries to reinforce mutual interests: <ul style="list-style-type: none"> ○ Profitable private sector to enhance tax revenue base ○ Increased employment at wage levels that reduce poverty ○ Public service delivery and high quality products ▪ Need to reduce Trust / Confidence gap ▪ Perceived lack of interest to take into account private sector’s concerns and issues. 	<p>A Government-Private Sector Forum, a bi-annual Cabinet-level meeting with the private sector, supported by working groups to define and resolve specific problems.</p>	<p>Step 1: Define Working Groups Step 2: Define Government and Private Sector Co-Chairs Step 3: Define Working Group members (to include key stakeholders, industry associations, customers of industry etc. Balance between public and private sector representatives) Step 4: Define Working Group Agenda Step 5: Propose Forum structure to Chief Secretary Step 6: Hold initial meeting to endorse Structure</p> <p>Responsible: Chamber of Commerce & Secretary of Industry Support: World Bank to provide sample structures at Forum’s request</p>
2. INCREASE BUSINESS REGISTRATION		
<ul style="list-style-type: none"> ▪ The NWFP Provincial mining policy framework has been streamlined, but does not extend to tribal areas. ▪ National policy recognizes resource as government property, and grants the right to exploit the mine on lease/concession. ▪ Without legal status, mines are vulnerable to security issues as well as arbitrary closure by local officials. ▪ Unofficial costs of Rs 7,000 per truck are common 	<p>That the vast majority of firms are registered, and registration data are computerized, enabling information sharing.</p>	

Construction Sector

Issues Addressed	Results Sought	Steps Needed
3. IMPROVEMENT AND STANDARDIZATION OF CONSTRUCTION CONTRACTS		
<ul style="list-style-type: none"> ▪ Contracts are one-sided and discriminatory and not enforced properly. ▪ Contract must enable arbitration, accommodate escalation of input prices and define maximum period of contract payment for better financial management. ▪ Lack of standardization in contracts (different contracts are used across agencies). ▪ Delay in adopting the PEC Standard Bidding Documents 	<p>Implementation of the PEC Standard Bidding Documents (including terms for Escalation, Arbitration and Payment Schedules) across all agencies that hire construction firms</p>	<p>Step 1: Review PEC Standard Contract documents. Step 2: Seek consensus on escalation and arbitration. Step 3: Seek approval of Secretary of Law and Secretary of Finance on adoption of standardized PEC contract.</p>
4. IMPROVEMENT OF THE PROCUREMENT PROCESS INCLUDING UNIFIED REGISTRATION		
<ul style="list-style-type: none"> ▪ Construction firms are required to register with multiple client agencies and the PEC. This leads to duplication of effort and resource wastage for both the client agencies and construction firms 	<p>Simplified, unified registration preferably under the auspices of the PEC</p>	<p>Step 1: Initiate discussion of harmonization of procurement processes with the PEC Step 2: Seek consensus on escalation and arbitration. Step 3: Seek approval of Secretary of Law and Secretary of Finance on adoption of contract. Step 4: Initiate discussion of harmonization of procurement processes with donors (not time-limited). Step 5: Create single registration system shared across agencies.</p>
5. CONTRACTOR PERFORMANCE MONITORING SYSTEM		
<ul style="list-style-type: none"> ▪ Collusion in prequalification and tendering ▪ Frequent budget overruns ▪ No incentive to construction firms for competition based on capability. 	<p>A system to monitor performance of private contractors, defined and pilot tested within a sample of contracts and refined for Provincial rollout</p>	<p>Step 1: Initiate discussion with PEC and provincial client agency to determine roles and division of responsibilities. Step 2: Define performance criteria (productivity in terms of output and deviation from schedule and budget; quality etc.) Step 3: Select pilot to launch performance monitoring Step 4: Assign internal personnel Step 5: Establish database Step 6: Discuss monitoring system design across agencies Step 7: Test pilot Step 8: Create link to new contractor selection Step 9: Refine pilot, scale up through Planning & Development Department Responsible: Director, FHA Support: World Bank to support through consultant</p>

Issues Addressed	Results Sought	Steps Needed
6. STRENGTHENING CAPACITY OF CLIENT DEPARTMENTS		
<ul style="list-style-type: none"> ▪ Weak public sector capacity to manage contracts and monitor the quality of construction. ▪ Inappropriate staffing and skills ▪ Unofficial costs resulting from inappropriate compensation and control structures ▪ Need for stronger incentives to public sector for increasing institutional performance. 	<p>Adequately staffed (right-sized), professionalized and properly equipped departments, with hiring, salary and promotion based primarily on performance and merit. Cost of institution will be realized through savings – reduced escalation and rework of projects.</p>	<p>Step 1: Define Performance Criteria. Step 2: Define measurement system. Step 3: Assign internal personnel / strengthen planning and monitoring cells Step 4: Define salary levels for reaching goals. Step 5: Initiate Pilot.</p> <p>Responsible: Director Planning & Monitoring, Works & Services Department, NWFP Support: World Bank to support through consultant</p>

Tourism

Issues Addressed	Results Sought	Steps Needed
7. DEVELOP A JOINT GOVERNMENT-PRIVATE PROVINCIAL TOURISM STRATEGY		
<ul style="list-style-type: none"> ▪ Issues: ▪ A lack of awareness of tourism potential, and no image building activity ▪ No NWFP tourism policy ▪ Investment proposals raised by STC in the past beyond government’s means, suggesting need for prioritization ▪ State maintains dual role as operator and policymaker ▪ Many policies are obsolete and require renewal, which requires better research and development ▪ A lack of direction for tourism investments and policies 	<p>A medium-term provincial strategy to guide investments in promotion, skill development, infrastructure and environmental protection.</p>	<p>Step 1: Agree on outline for joint sector strategy. Step 2: Conduct research on potential NWFP “products” Archeological Sites, tangible built heritage and antiquities Wildlife and natural resources Artistic heritage including performance arts and festivals Agriculture and Cuisine Handicrafts Step 3: Conduct research on market segments: Demographic data Market size Surveys Step 4: Community-level awareness building and research Interviews of tribal leaders to promote understanding of tourism</p> <p>Responsible: Tourism Working Group committed to developing outline. World Bank to support through consultant.</p>

Issues Addressed	Results Sought	Steps Needed
8. REFORM THE STC TO CREATE A HIGH-PERFORMING INSTITUTIONAL STRUCTURE FOR TOURISM		
<ul style="list-style-type: none"> ▪ Sec Tourism and STC directly responsible for a small share of issues that impact tourism. ▪ Need stronger coordination with security, transportation, agriculture, wildlife, archeology, zoning, water and sanitation. ▪ Need to better leverage private sector. ▪ Top-down Federal role prevents community empowerment. ▪ Federal government has neglected the NWFP tourism assets. ▪ STC organizational resources are extremely limited. 	<p>An efficient organization that (a) enables policy coordination across relevant agencies; (b) empowers private sector and local communities; (c) implements the defined strategy.</p>	<p>Consultant report ongoing.</p>

Marble and Gemstone Mining

Issues Addressed	Results Sought	Steps Needed
9. STRENGTHEN PROPERTY RIGHTS FOR MINING		
<ul style="list-style-type: none"> ▪ The NWFP Provincial mining policy framework has been streamlined, but does not extend to tribal areas. ▪ National policy recognizes resource as government property, and grants the right to exploit the mine on lease/concession. ▪ Without legal status, mines are vulnerable to security issues as well as arbitrary closure by local officials. ▪ Unofficial costs of Rs 7,000 per truck are common 	<p>Legal recognition of the status of mines throughout NWFP, and the extension of provincial policy to those mines.</p>	<p>.</p>