"MAKE IN PAKISTAN" THRUST

December 2017

The Pakistan Business Council (PBC) is a business policy advocacy platform, composed of Pakistan's leading private-sector businesses. Its objectives are to facilitate and foster economic, social and human resource development. PBC members are engaged in thirteen important sectors of manufacturing and services and include 25 MNCs from 12 countries. Together, PBC members account of 11% of Pakistan's GDP and nearly every fifth Rupee of annual tax and export revenues. They directly employ 400,000 with millions more in the extended value chain. More information is available on www.pbc.org.pk

PBC Member Companies

Abbott A Promise for Life	AkzoNobel	AlliedBank	Artistic Milliners
mayfair Asian Food Industries	Atlas	Bank Alfalah Limited	CHERAT CEMENT
Coca-Cola	Colgate Palmolive	Dawood Hercules	DESCON
efu	The Legend Leads. English Biscuits Manufacturers	engro corp	engro foods
faysalbank	FEROZSONS LABORATORIES LIMITED	GATRON	Getz pharma
gsk GlaxoSmithKline	gsk GlaxoSmithKline Consumer Healthcare	GulAhmed TEXTILE MILLS LIMITED, KARACHI	HBL
HASCOL	HUBCO	ICI PAKISTAN	interloop
IIL International Industries Ltd.	INDUS GROUP	TOYOTA DAIHATSU INDUS MOTOR COMPANY LIMITED	JDW JDW Sugar Mills

JS BANK	KE Energy That Moves Life	LOTTE	LUCKY CEMENT
MEGA MEGA CONGLOMERATE	MTL Millat Tractors	National FOODS SINCE 1970	Nestlé
NISHAT MILLS LTD	Martin Dow Pharmaceuticals for a Changing World	PACKAGES Limited	pakarab FERTILIZERS LIMITED
PSL PAKISTAN SERVICES LTD.	ptcl	PAKISTAN TOBACCO COMPANY	PHILIP MORRIS INTERNATIONAL Philip Morris International
rb Reckitt Benckiser	SAIF GROUP	Sapphire	Shan
SICPA	SIEMENS	Soneri Bank	SOORTY World Of Denim
HUTCHISON PORTS PAKISTAN South Asia Pakistan Terminals	Standard Chartered	SPEL Synthetic Products Enterprises Limited	TAPAL
TCS WE MOVE YOU	PROTECTS WHAT'S GOOD Tetra Pak	TPL Holdings Tomorrow Delivered Today	Tufail Chemical Industries Ltd.
	UBL	Unilever	

The *“Make in Pakistan”* Thrust

The key thrust of the Pakistan Business Council’s Agenda for the Economy is *“Make in Pakistan.”* Manufacturing in Pakistan lags our Asian peers and the economy is increasingly driven by import-based consumption, which now represents over 80% of GDP. Investment in industry is half that of our neighbouring countries. As a result, employment has been compromised and the country has had to resort twelve times to the IMF in the last three decades. The only sustainable solution is fundamental reforms. Domestic industry suffers from flaws in and conflicts between trade, fiscal, industrial, energy and agriculture policies, all of which need to be aligned to provide a holistic and conducive long-term policy to encourage further investment. The PBC seeks a national consensus from all stakeholders to promote domestic industry.

It is important to elaborate what “*Make in Pakistan*” is and what it is not:

IT IS ABOUT

- Long term policies to encourage investment in and the revival of manufacturing in Pakistan. Thus reverse the reliance on imports and avoid the recurrent cycles of pressure on the external account.
- Creating jobs and upgrading human capital to boost productivity.
- Adding sophistication to Pakistan’s industrial output, broadening the export relevance beyond traditional products and destinations and promoting import substitution.
- Leveraging Pakistan’s consumer base of 207 million to build scale, starting with everyday needs. As industry becomes cost and quality competitive, deploy scale for export.
- Reposition Pakistan to the Middle-Income Country status.

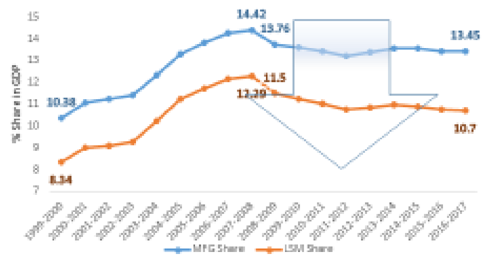
IT IS <u>NOT</u> ABOUT

- Providing a captive market for inefficient industry at the expensive of consumer choice.
- Supporting a tariff structure which prevents access of raw materials and intermediate goods at competitive prices to export industries.
- Creating monopolies in the name of “minimum economic size.”
- Protecting industry at the bottom of the value chain, producing basic raw materials and low value intermediate products.
- Allowing the exploitation of labor in the name of “cost equalization” with regional competitors.

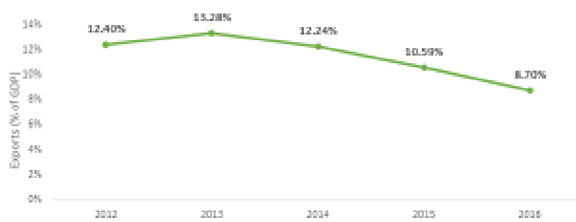
THE EVIDENCE

Wake-Up Call – Manufacturing & Exports declining

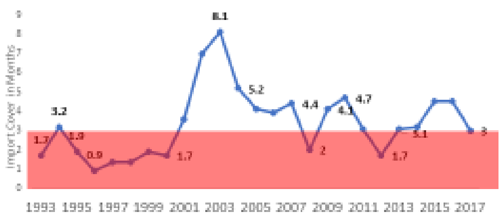
Country De-Industrializing Prematurely



Share of Manufacturing in Exports Declining

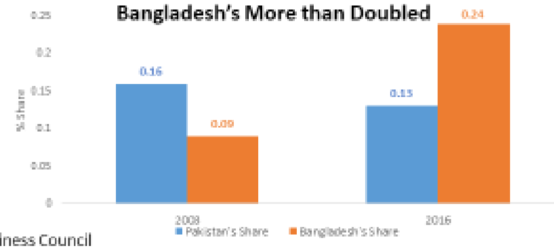


12 Cycles of External Account Crises in 24 Years



Since '88, Pakistan has been to IMF 12 times.

Pakistan's Share of World Exports Down, Bangladesh's More than Doubled



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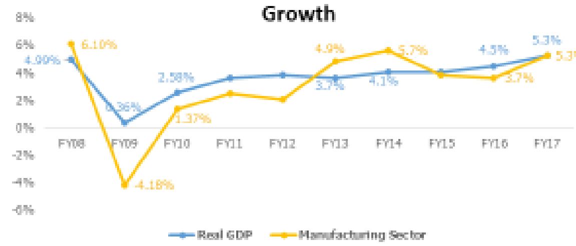
Wake-Up Call –Industry over-taxed and lagging peers

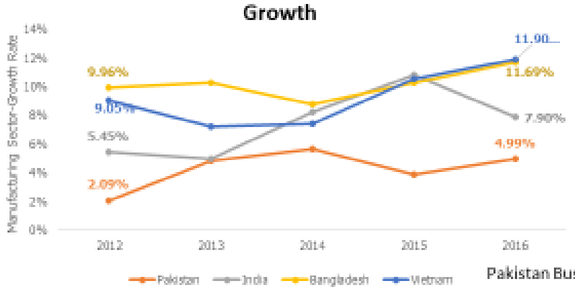
Industry Carries Disproportionate Burden of Taxes

	% Share in GDP	% Tax Rev
Agriculture	19.5%	<1%
Manufacturing	13.5%	58%
Retail/Wholesale	18.5%	1%
Services Total	59.6%	37%

Growth of Manufacturing Closely Correlated with GDP Growth



Pakistan Lags Behind South Asia in Manufacturing Growth



Pakistan's Economy is Fueled by Consumption and Industrial Investment Lags South Asia

% of GDP	Pakistan	Sri Lanka	Indonesia	India	Bangladesh
Private Consumption	80.1%	69.4%	56.5%	60.8%	70.3%
Government Consumption	11.8%	8.7%	9.3%	11.4%	5.2%
Investment	15.2%	29.5%	34.2%	30.6%	31.2%
Net Exports (X-M)	-7.1%	-7.6%	0%	-1.8%	-6.7%

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Wake-Up Call –Agriculture & input costs not supportive

Agriculture Dominates GDP but Agro-Output Lags World's Best

% GDP	Pakistan	India	Indonesia
Agriculture	19.5%	16.5%	13.7%

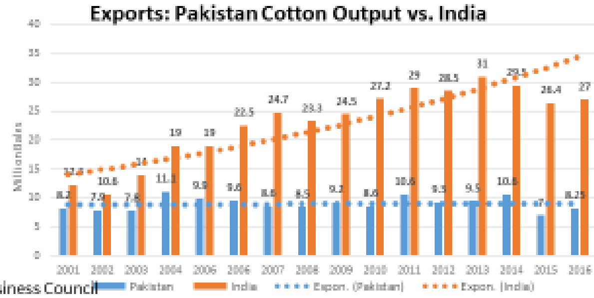
Pakistan Output % vs. World Best	
Wheat	36%
Cotton	52%
Sugar Cane	51%
Maize	41%
Rice	29%

Energy and Labour Cost are twice South Asia's

	Gas cost	Labour cost
Bangladesh	1.9 x	2 x
India	1.8 x	2.3 x
Sri Lanka	2.6 x	1.9 x

- Mainly subsistence-led. Livestock and dairy an after-thought. Meat and milk output sub-optimal
- Land levelling, salinity, poor water management, indiscriminate application of fertilizers and pesticides
- Government support price driving unwarranted surpluses in wheat and sugar at the expense of cotton. Low cotton yield also due to poor seeds.
- High waste due to poor cold chain

Cotton Output Inadequate to drive Growth in Textile Exports: Pakistan Cotton Output vs. India



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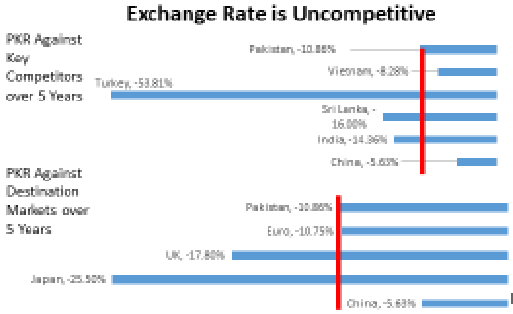
Issues – FTAs and Exchange regime not helping

Poorly Negotiated Trade Agreements

COUNTRY	YEAR SIGNED	TRADE BALANCE THEN	TRADE BALANCE 2016
Sri Lanka	2005	$0.094 Bn	$0.24 Bn
China	2006	$(3.2) Bn	$(15.32) Bn
Malaysia	2008	$(1.55) Bn	$(1.0) Bn
Indonesia	2013	$(1.06) Bn	$(1.86) Bn
Mauritius	2007	$0.035 Bn	$0.17 Bn

Exchange Rate is Uncompetitive



Growth in Import Reliance, Mainly on China

ITEMS	Imports 2007 * US$MN	Imports 2016 * US$MN	Growth Multiple	Est. % from China
Footwear	34	103	3x	90%
Pumps	47	171	3.6x	61%
Glassware	13	74	5.6x	90%
Tiles	50	170	3.4x	75%
Blankets	17	46	2.7x	98%
Fans	25	69	2.7x	80%

Caution with Proposed FTAs with Turkey and Thailand

- Significant mismatch between Pakistan's export capability with those of Turkey (1:3) and Thailand (1:4). Pakistan already enjoys relatively low tariff access to both countries for what it can export
- Both Thailand and Turkey desire access to Pakistan's automobile, auto-parts, chemicals, plastics and rubber markets, which would undermine existing industry
- Turkey is one of the highest users of trade defenses, even against its FTA partners!

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Issues – Fiscal regime favours importers and traders

High Tax Rates

	Corp Tax %	VAT/GST%
Pakistan	38%*	17%
Singapore	17%	7%
Sri Lanka	15%	12%
Bangladesh	25%	15%
Vietnam	22%	10%

- Includes WWF/WPPF/Super Tax

Complex Tax System

COUNTRIES	Doing Business '18 PAYING TAXES Rank (Out of 190)	Payments (Number Per Year)	Time (Hours Per Year)	Total tax and ate (% of profit)	Post-filing Index (0-100)
Pakistan	172	47	311.5	33.8	10.49
India	119	13	214	55.3	49.31
Bangladesh	152	33	435	33.4	44.38
Sri Lanka	158	47	168	55.2	49.31
Vietnam	86	14	498	38.1	95.71

Presumptive Tax Regime Encourages Imports

Heading	Declared Value as % of Actual Value		
Declared or Assessed Value	100%	60%	40%
Declared or Assessed Value	100.00	60.00	40.00
Customs Duty @ 20%	20.00	12.00	8.00
Regulatory Duty @ 25%	25.00	15.00	10.00
Value after CD & RD	145.00	87.00	58.00
Sales Tax @ 17%	20.40	12.24	8.16
Additional Sales Tax @ 3%	0.00	2.16	1.44
Value after ST & Additional ST	165.40	101.40	67.60
Withholding Income Tax on Commercial Importers @ 6%	8.42	5.05	3.37
Landed Cost on books	173.82	106.45	70.97
Difference in Cost	0.00	40.00	60.00
Financial cost of Hawala @ 4%	0.00	1.60	2.40
Actual cost of imported goods	173.82	148.05	133.37
Cost Advantage to Unscrupulous importer	0.00	25.77	40.45
Cost Advantage % terms	0.0% (IMPORTS @ 100%)	17.4% (IMPORTS @ 60%)	30.3% (IMPORTS @ 40%)
LOSS TO EXCHEQUER		Rs.28 or 38% of formal sector contribution of Rs. 74	Rs. 43 or 58% of formal sector contribution of Rs. 74

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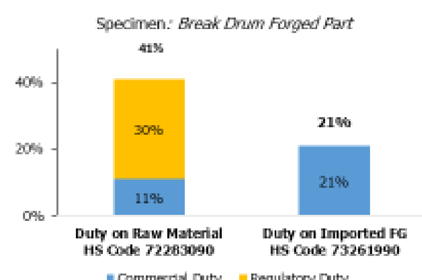
Issues – Tariffs not supportive of manufacturing

Tariffs Not Always Cascading – Specimen: *Shoes Manufacturing*

	Customs Duty	Regulatory Duty	Total Duty
Raw Materials	3% - 25%	-	3% - 25%
Semi-Finished Goods	20%	25%	45%
Finished Goods	20%	25%	45%

Regulatory Duty on Raw Materials



Fiscal Regime Does Not Encourage Capital Formation/Accumulation

- Imposition of Super Tax
- Tax on profit accumulation
- Cascading tax on inter-corporate dividends
- Restricted group loss relief
- ETR on shareholders > ETR on indirect
- Minimum tax on turnover even at commencement of business
- Tax on companies/their shareholders higher than on indiv/AOPs

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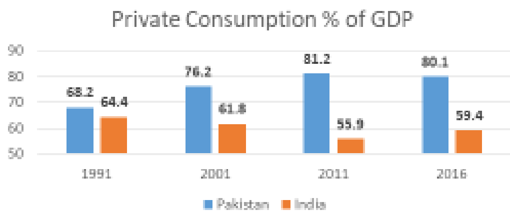
Issues – Consumption drives the economy

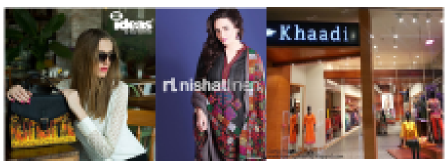
Consumption, fueled by imports, dominates the economy and exceeds india's by 2060 bps



FDI mostly Motivated by Consumption

- Nestle $450 Mn investment in milk chain
- Coca Cola $ 380 Mn expansion
- 2013: Unilever (GB) parent bought out minority (c.24%) for US $ 530 Mn
- 2016: Friesland Campina (NL) acquired 51% of Engro Foods for approx. US $ 44 Mn
- 2016: Lotte (S Korea) buying substantial share in Pepsi Lahore bottler
- 2016: Arcelik of Turkey acquired Dawlance Appliances for $250 Mn

Large Exporters Turning to Local Market



Big Industrial Groups Entering Retail Real Estate

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ACTION POINTS

The salient actions from aligned policies to promote domestic industry, which should ideally be overseen by the Prime Minister, are listed below:

	Thrusts	Action Points
1.	Stop undermining domestic industry through ill-negotiated trade agreements. (Ministry of Commerce)	- Complete the renegotiation of the Pak China FTA. - Move with caution on agreements with Turkey and Thailand. - Factor impact on jobs and tax collection into future agreements. - Encourage value-added exports, not just of commodities.
2.	Create a more level playing field for the formal sector (Ministry of Finance, the FBR and the Ministry of Commerce)	- Replace the presumptive tax regime for commercial importers with advance, adjustable tax. Oblige all in taxable activity to file tax returns, even if they do not have taxable income. - Ensure cascading tariffs on raw materials, intermediates and finished goods to promote local production and import incorporation into value-added exports - Remove Regulatory duty on raw materials and intermediates not available in Pakistan - Impose specific duties in addition to ad-valorem levies to provide a check on under-valuation. - Replace weight based duties on high value-added components with ad-valorem levies to reflect proper value. - Ensure that the National Tariff Commission is continuously functioning. - Stop the brazen sale of smuggled goods. - Levy import duty and GST on goods in transit to Afghanistan which should be refunded to the Afghan government on export from Pakistan.
3.	Provide reliable energy at competitive cost (Ministry of Power)	Provide reliable energy to industry at costs competitive with Bangladesh and India. Energy cost in Pakistan is presently twice that of these countries.
4.	A long-term, consistent, export policy to replace knee-jerk, short-term packages (Ministry of Commerce and Finance)	Replace the 12-18-month export package with a 5-year, broad - based export policy to promote investment in capacity and capability building. Factor into rebates the exchange rate competitiveness and input cost disparity. Encourage value-addition and export destination diversification through graduated rebates. Automate rebates to ease cash flow.

5.	CPEC SEZs not to undermine existing employment and exports (Finance and Planning)	- Ensure concessions to SEZs under CPEC do not undermine existing industry. Net job creation and incremental exports should be the aim. - Strengthen controls to minimize leakages of CPEC transit goods and avoid a repeat of the misuse of the Afghan Transit Treaty.
6.	Fiscal policy should encourage corporatization, capital formation, accumulation, consolidation and investment (Ministry of Finance/FBR)	- Withdraw Super Tax - Abolish tax on less than 40% profit distribution - Remove cascading tax on inter-company dividends - Encourage risk-taking by withdrawing minimum tax on turnover for first three years of a business and then tax at half the rate for the following two years. - Promote corporatization through parity taxation of company profits and dividends with sole-traders and AOPs. - Restore the group taxation regime enacted in the Finance Act 2010 to promote holding companies and wider shareholder participation.
7.	Fiscal reforms to simplify, ease and bring down cost of doing business. (Ministry of Finance/FBR)	- Separate the tax policy making from tax collection. Tax policy making body should have representation of the private sector. - Make FBR's main KPI, the amount of tax collected from new tax payers as opposed to the current KPI of total tax revenue. - Address the technology and talent needs of tax collection. - Reduce over 5 years, the direct tax rate to 20% and GST to 7% - Unify provincial and federal tax collection under a single national tax authority. Reduce multiplicity of taxes from the present 47. - Simplify and automate return filing and input/output tax offsets - Resolve jurisdictional issues between the federation and provinces and intra-provincial disputes on applicability
8.	Encourage low and medium cost housing to address acute shortage and to generate substantial employment (State Bank of Pakistan)	- 10 mn backlog with 0.5 mn annual need for low- and medium-cost housing would generate millions of jobs - A government mortgage refinance bank should provide revolving tranches of long-term funding. - Automate land records to create title visibility - Strengthen laws to facilitate repossession and resale in the event of default - Create valuation transparency - Incentivize borrowers with fiscal relief on mortgage loan cost - Allow collateralization of up to Rs. 5 m of property without wealth accountability for tax - fiscal regime for development REITS be reviewed
9.	Grow private sector credit, especially to the SME sector (State Bank of Pakistan)	- Total private sector credit as % of GDP in Pakistan is amongst the lowest in the world. SME credit is negligible. - Banks prefer to lend risk-free to the government. - Credit guarantee scheme with a specified minimum lending criterion, especially for the SME sector is required.

<table>
<tr><td></td><td></td><td>- Banks should be encouraged to think of out-of-the-box solutions to manage exposure.
- The banking system needs to build appetite and resources for long-term project finance.</td></tr>
<tr><td>10.</td><td>Policies to encourage new ventures, especially in IT.
(Ministry of Finance/FBR)</td><td>- three-year tax holiday for new ventures and half the minimum tax on turnover for the following two years
- Make internet affordable by reducing incidence of taxes on cellular equipment, cell-phone use and fixed line internet
- Promote venture capital funds
- Allow banks to take up to 5% exposure of their assets to private equity. Review private equity regulations to encourage further investment.</td></tr>
<tr><td>11.</td><td>Transform agriculture and livestock
(Provinces)</td><td>- Gradually withdraw farm support price for wheat and sugar to avoid un-exportable surpluses
- Encourage efficient cotton growing to provide quality and cost competitive input to the main value-added export industry
- Move livestock and dairy from subsistence farming to optimize yield and address the global shift from cereals to meat
- Encourage co-operative farming and promote mechanization
- Invest in land-levelling, seeds, water storage and water course improvement
- Irrigate 22 mn more acres of land in Eastern Baluchistan, Southern KPK, Southern Punjab and Northern Sindh</td></tr>
<tr><td>12..</td><td>Allow business to partner the government in improving lives, promote gender balance and upskill the labour force.
(Ministry of Finance/FBR)</td><td>(WWF=Workers Welfare Fund)
<table>
<tr><th>UN SDG GOAL</th><th>FISCAL INCENTIVE</th></tr>
<tr><td>Goal 3: Healthy lives; wellbeing for all</td><td>• Allow business to use the WWF contribution to fund hospitals/clinics and to address malnutrition and stunting of children</td></tr>
<tr><td>Goal 5: Gender equality; women’s empowerment</td><td>• 25% rebate in the effective tax rate on salary income for full time working mothers to enable them to secure child care</td></tr>
<tr><td>Goal 6: Sustainable water; sanitation for all</td><td>• WWF offset for investment in drinking water purification plants</td></tr>
<tr><td>Goal 8: Sustained, inclusive and sustainable economic growth; full and productive</td><td>• WWF offset for the investment in approved vocational training institutes.
• Investment Allowance for investment for the specially challenged in the workplace</td></tr>
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			employment; and decent work for all	• 0.5% lower Tax Rate for jobs to challenged persons (min. 5% of work force) • 1% lower tax for 50+ new jobs on existing company's own payroll	
			Goal 9: Inclusive and sustainable industry	• Investment Allowance for investment in renewable energy for factories, warehouses and offices • Investment Allowance for investment in effluent treatment plants	
			Goal 12: Sustainable production and consumption	• 0.5% lower tax for reduction in waste, achieving/maintaining zero landfill • 15-year tax holiday for investment in a standalone waste management business • 0.5 % lower tax for reduction in the material footprint of the supply chain	