

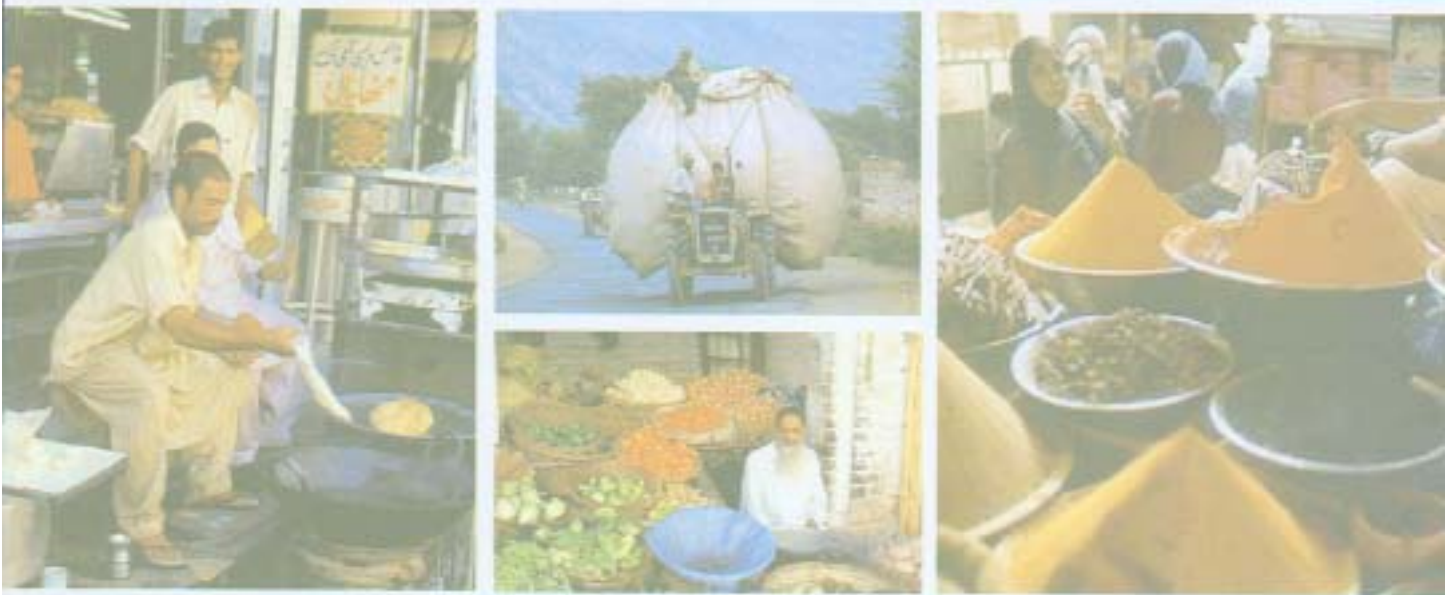


PAK/03/013

Trade Initiatives from a Human Development Perspective



## DOMESTIC COMMERCE - THE MISSING LINK



*Edited by*

Nadeem Ul Haque and S. Izzah Waqaar

28<sup>th</sup> January 2006

Room #. 621, Ministry of Commerce, A - Block, Pak Secretariat, Islamabad, Pakistan  
Tel. #: ++92-51-9224455, Fax #: ++92-51- 9216263  
E-mail: [tihp@comsats.net.pk](mailto:tihp@comsats.net.pk), [www.tihp-undp.org.pk](http://www.tihp-undp.org.pk)

REPORT

ON

A conference on

**DOMESTIC COMMERCE – THE MISSING LINK**

Edited by

Nadeem Ul Haque and Izza Waqar

28<sup>th</sup> January 2006

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## **I. EXECUTIVE SUMMARY**

Participants in the workshops noted the following factors as constraining domestic commerce:

- Lack of educated and trained human resource. Education system not delivering the kind of manpower required.
- Lack of physical infrastructure. Poor road network. Limited, expensive and uncertain electricity.
- Frequent changes in Government policies.
- Fundamentalists can impact commerce without threat of state reprisal.
- Lack of copy right protection.
- Inadequate property rights. Acquiring land very difficult, uncertain and time consuming.
- Inequitable tax laws and unnecessary tax burdens.
- Problems in securing financing and credit.
- Quality control and inadequate domestic standards.
- Poor quality of IT infrastructure limits management control for extensive branching.
- Weak contract enforcement hinders supply chain development and delegation to middle management.
- Outmoded and non-professional urban zoning very unfriendly to commercial development.

- High commercialization fees a tax on commercial development.
- Difficult land acquisition procedures for commercial purposes.
- No zoning for warehousing and distribution with the result that warehousing continues to be done in dilapidated old housing.
- State favors industry with industrial parks, no commercial or retail parks.
- Government controls large tracts of prime commercial land inhibiting city center development. This land must be privatized.
- Retail zoning in housing projects is too small to allow shopping mall and large warehousing development.
- No city centers are allowed to develop as dense mixed use areas.
- No tourism to support retail development.
- No hotel infrastructure to allow a distribution network to develop.
- Poor system of tracing and penalizing smugglers and fraudulent parties.
- Lack of cultural events to present a softer picture of our society.

### **Desired Future State of Domestic Commerce in Pakistan**

All were of the view that while addressing constraints above, we need a vision for domestic commerce along the following lines:

Cities in Pakistan should be independent and large commercial centers where mixed-use activity abounds with plenty of office, retail, warehouse, leisure, hotel, and other commercial space.

For this we will require:

- Professional urban management that is sensitive to mixed use city center and commercial development.
- Change of mindset that favors single family homes for the rich over commercial development and middle class housing.
  - Commercialization fees that penalize commercial development should be removed.
- City center government land must be privatized and those large tracts be made available for mega commercial projects that will include hotels, shopping malls, office space and flats.
- Secure and transparent property rights including property tights and brand name protection.
- Improvements in the legal and judicial system for speedy contract enforcement.
- Roll back fundamentalism and limit their ability to influence commerce.



## **II. OPENING SPEECH**

MR. HUMAYUN AKHTER KHAN  
MINISTER FOR COMMERCE

## **MOC AND DOMESTIC COMMERCE**

MOC has in the past maintained a strong effort for export promotion and obtaining market access. The main emphasis has been to expand exports and we have been very successful in that---- doubling our exports in the last 5 years.

Following a recent review of the MOC that our trade policy advisor, Dr. Nadeem Ul Haque conducted, I have decided that MOC needs to develop new approaches to strengthening domestic commerce. Indeed Nadeem is right that this has been the missing link in our growth strategy.

I am now convinced that getting the policy framework right in this sector will not only contribute significantly to developing robust growth but also to alleviating poverty.

Domestic commerce which includes retail and wholesale trades, restaurants and hotels, construction, transport storage and communication, financial and real estate and personal services according to the labour force survey now employs about 35 to 40 percent of the people. Agriculture employs about 43 percent of the labour force. The sector is obviously of great importance to the welfare of the people. We should at least understand this sector.

The share in GDP of the services sector is over 50 percent. It is the largest contributor to GDP. Yet as we can all see it is a fairly underdeveloped sector. The retail sector, the hotel sector, transport, construction, the real estate business—indeed services in general all remain very underdeveloped. What is stopping this sector from growing? We need to find out! If we can unleash this sector, I think we will have a min-boom. Investment will boom the economy will boom. There is great potential here.

This sector is also where the poor and the middle class are hidden. The small shopkeeper, the rerhi wala, the unskilled labourer. It contains the largest number of small and medium enterprises. Indeed fixing this sector is the SME policy. If we make this sector boom we will have a more egalitarian development.

While we must maintain an open international stance to integrate our economy into the global economy, we must develop markets at home. What we import and what we export is a product of these domestic markets. Efficient and well developed domestic markets fuel the economy as well as international trade. Domestic commerce is about domestic markets.

If we are able to develop these domestic markets, we will be able to develop brand names for high margin exports. Brand names are developed in competitive domestic markets and then exports. We have many examples in front of us Coke, Pepsi, McDonalds, Pierre Cardin, and Marks & Spencer etc.

MOC, as a responsible economic ministry, has developed plans within the ambit of its work for dealing with your stated goal of economic development with poverty alleviation. Some of these are:

- We are undertaking a large review of commerce in the country. To keep the state of commerce under constant scrutiny, we will prepare an annual report on commerce starting 2007.
- We are beginning a large dialog with the private sector on the state of commerce as part of our review.
- We will be beginning an extensive dialog with the provincial and local governments to catalyze thinking on the issue of developing local commerce everywhere.

Through these initiatives, we hope to continuously evolve a policy for making Pakistan a hub for commerce that impacts most positively on the poor of Pakistan. We think that our approach will also contribute most significantly to the sustenance of economic growth to the point of making Pakistan a middle income country.

These efforts will also completely modernize the ministry of commerce bringing it more in line with the department of commerce in the US and the Department of Trade and Industry in UK, both of which are “providing a conducive environment for entrepreneurship and local business development”.

I have a vision that some Pakistani cities can someday become an important commercial hub of the region, a tourist destination, a shopping centre, regional headquarters for Multinational Corporation. Globalization offers us these opportunities and we must seize them. Our cities should have shopping malls, hotels, offices buildings, flats leisure activities and much else. The first step is to develop domestic commerce and domestic markets. With this conference we have embarked upon this effort.

I thank all the speakers for helping us think through this problem. Please help us build a better market for you. Provide us with all your ideas and suggestions and we will build these markets in Pakistan. Let us all also thank Dr. Nadeem Ul Haque for giving us a fresh approach and bringing to us new ideas. We in Pakistan must encourage fresh thinking and allow technical people into government to make good things happen. Finally let us thank the ministry officials who helped organize this conference with Nadeem.

**III. KEYNOTE ADDRESS ON THE CONFERENCE  
THEME**

Dr. Nadeem Ul Haque  
Trade Policy Advisor for Ministry of Commerce

## **WHY DOMESTIC COMMERCE IS THE MISSING LINK?**

Lord Keynes, the most influential and famous economist, said many years ago

*“The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else. Practical men, who believe themselves to be quite exempt from any intellectual influence, are usually the slaves of some defunct economist. Madmen in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years back.”<sup>1</sup>*

Pakistan has lacked think tanks and universities for many years. Economic thinking and debate is seriously discounted often being left to non-professionals.<sup>2</sup> Following Keynes, we may be following yesterday’s defunct economists. Perhaps it is time that we began to rethink our fundamental economic strategy.

### **Static Growth Paradigm**

For many years, our growth strategy has followed the Harvard Advisory Group thinking, which Dr. Mahbub Ul Haq so eloquently presented in his book 'strategy for economic planning'. It is based on three pillars: chasing industrial production, a mercantilist approach for developing foreign exchange surpluses, a large and dominating role of the government with a suspicion of the market and the private sector.

In keeping with this thinking, we continue to promote production, especially industrial production, often with concessions. In past we have given this sector substantial subsidies-cheap interest rates, land below market rates, energy subsidies etc. More recently we have eliminated almost all subsidies. However, an interest rate subsidy still

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<sup>1</sup> John Maynard Keynes (1883-1946) ‘The General Theory of Employment’, Interest and Money, ch. 24 (1936).

<sup>2</sup> See Nadeem Ul Haque and Mahmood Hasan Khan ‘The Economics Profession in Pakistan’ PDR 1998

remains as interest rates have been negative in real in recent years. The government continues to develop industrial estates to help industry.

In keeping with the thinking of the sixties we also continue to believe in the 2-gap model, the 2 gaps being a domestic saving shortage and a foreign exchange shortage. Planning calculates a domestic investment need based on desired growth on industry. This investment need is always larger than our domestic savings and hence sends the government continuously to the donors to look for financing.

Since the emphasis is on industrial development, state planning also needs to find the foreign exchange that will be required for importing the capital that is necessary for this goal. For this reason strategies to conserve foreign exchange have pervaded our history. For much of our history, we have had stringent capital controls, used every conceivable subsidy for export promotion and maintained high tariff walls for consumer goods. The result of this policy has been that our domestic consumer lives with substandard consumer goods while our exporter exports basic commodities and simple manufacturing goods such as the very basic textile and clothing items. An emphasis on export promotion and import substitution industry is supposed to help our foreign exchange earnings. In history this is known as mercantilism and has been clearly proven not to be a policy that should be pursued for any length of time.

If you read Dr. Mahbub Ul Haq's classic on economic planning you will find all these principles very well discussed. He also pointed out how and why the government needed to lead the economic development process. It was believed then that the government always knows best and must direct the economy. Few however, remember that Dr. Haq also mentioned the weaknesses in the bureaucracy that might make it difficult to implement the plans that were being devised. We continue to let the government dominate the economy and the market, while letting the bureaucracy remain in charge in its non-technical and unreformed state.

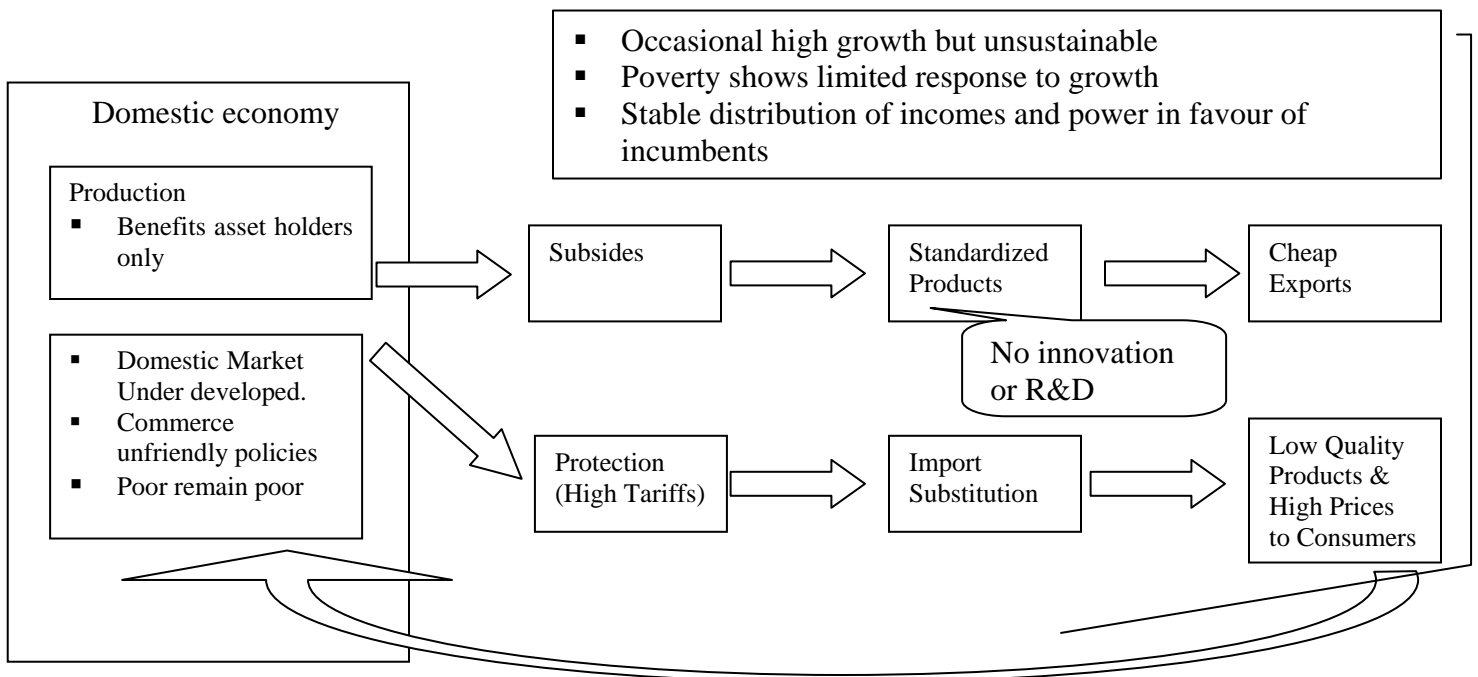
Chart 1 illustrates the current strategy, which emphasises production and mercantilism. In this scheme, policy emphasizes production for both export and imports substitution. Exports are based on basic products like knitwear and garments and some agriculture while imports are heavily taxed allowing for low quality import substitution. The result is

that new product development and entrepreneurship are seriously impeded. Consumer markets remain underdeveloped because policy discourages them and the lack of markets further reinforces the stunted development of entrepreneurship and new product development.

### Why not a consumer focus?

Much has been learnt about the growth process in the world and this knowledge needs to be applied in Pakistan. The earlier approach based on government-centered planning, reliance on foreign resources, and mercantilism, has not worked because the structure of incentives that resulted from this approach led to the neglect of governance, development of rent seeking, and a society that did not nurture talent. There is an urgent need to shift the growth paradigm in Pakistan. Let us see how!

**Chart 1: Current Strategy – Stifled Domestic Commerce**



An economy is an integrated whole which works best when all participants in it share the benefits of trade and growth. A long time ago, Adam Smith, the father of economics, pointed out that all economic agents could maximize their welfare if they were freely



allowed to trade with each other and the rest of the world. Much economic literature exists to show that the mercantilist approach of incentivizing export promotion and import substitution is not an optimal strategy. Export promotion and import substitution can be (and in Pakistan that is the case) followed at the cost of domestic markets and consumers. For example, exports are subsidized to provide the foreign consumer a Pakistani subsidy while imports are heavily taxed for import substitution to make Pakistani consumer goods very expensive. This leads to inadequate trading at home and welfare loss to domestic consumers. It also means that inadequate investments are made in domestic market development since the products are expensive and consumers poor. In this situation the only driver of change is the external sector and external demand.

Nobel Laureate Hayek had pointed out that markets where consumer demand was clearly articulated are the nervous system of an economy. Well functioning markets clear demand and supply through price adjustments, which convey relevant market information to all producers and consumers. Consumer markets are therefore the ‘front end’ of the economy where the demand and supply of many products, brand names, new products and new services are all equilibrated through the price system. In such markets innovations and entrepreneurship thrives through risk taking and understanding of tastes and markets.

Stifling domestic markets while trying to push the external sector, as has been done in Pakistan, results in lopsided development. The economy is a system that needs to work as a whole, with domestic and external trade supporting each other. It is in domestic markets that all manner of innovation and entrepreneurship can take place which later will move out and lead to higher exports and foreign exchange earnings. Entrepreneurs and innovators need neighborhood markets to perfect their products, brands and recipes, which they will then export. Multinationals like Coke, McDonald’s, and Ford all started as domestic industries. Their testing ground was domestic consumer market.

In the current paradigm of industrial mercantilism, we have never moved beyond the export of the most basic goods—simple textiles and basic commodities. All manner of committees argue for “more value-added exports” or “move up the value chain!” Yet this is not happening. Perhaps the missing link is domestic commerce?

Chart 2 shows a schematic illustrating the consumer-focussed growth paradigm that will develop if the proposed domestic commerce strategy is adopted. In this strategy, domestic consumer markets are allowed freedom resulting in the development of entrepreneurship and new product development. Many new activities and businesses are developed. These new goods and brand names that are developed develop new export markets. More importantly in this model not only goods are exported but there is a greater likelihood of businesses being exported leading to the birth of the Pakistani multinational. Examples of this process include 'Guess', 'Samsung' and 'Sony.' Even today, Sony releases many new products in Japan first before exporting them. This is how international experience develops value-added exports that committees and planners are asking for—through the development of domestic commerce.

In 'production/mercantilism' paradigm, we are able to achieve high rates of growth periodically. In the sixties we were able to attain 6 percent, in the eighties we were able to get 7 percent per annum and now in the 2005 we have been able to get to 8 percent. In the past this growth was not sustainable. For the future, we have to wait and see. But in each growth spurt, poverty was not eradicated or reduced significantly. If the growth paradigm were to shift and policy were friendlier to commerce and markets allowing cities that were commerce friendly then I would propose 2 hypotheses

1. Growth on broader foundations of deep domestic markets and commerce friendly cities would be higher and more sustainable.
2. Poverty would decrease more dramatically since the poor are mostly engaged in domestic commerce activities since they have no capital or assets.

### **The state of domestic commerce**

No one has any idea of what internal commerce is nor do we know what our policy towards it is. Is it constrained or is it a vibrant sector? We do know that this sector is the largest employer, providing for all segments of society especially the poorest (See Tables 1 and 3). This sector touches all. Yet we know nothing of it. There is no government department that collects any information on this sector or reviews the various policies and regulations that affect this sector.

Domestic commerce in Pakistan is a forgotten sector even though the labour force survey says that services which reside in this sector employs about 34 percent of the labour force (see Table 1 and 2). It contributes to more than half of our GDP.

Urban zoning remains uninformed of modern city and commercialisation needs. This perhaps is the biggest constraint to serious domestic commercial development. It continues to regard all forms of domestic commerce as an orphan child demanding large commercialization fees and leaving it only with residual space. Zoners are strongly biased towards large single-family homes on the style of large American suburbia. The only difference is that they do not allow shopping malls in this suburbia. In such cities there is no space for large retail or warehouses or storage or offices or mixed use where the poor and the middle classes can live. In fact, there are no city centres as mixed use, where commerce and the middle classes commingle, is not allowed. In any case, the government continues to own city centres.

Urban zoning is in particular very unfriendly to the poor retailer who lacks the capital to get into structured expensive retailing that in any case is in short supply. Unlike Bangkok, Hong Kong and Singapore, urban zoning allows no space for street vending through kiosks in city centres. This change alone could have a huge impact on poverty.

In keeping with the prevailing growth paradigm, taxation seems to visit this sector more than the policy-favoured sectors-- industry and export. Resistance by the sector to unfavourable tax zoning and regulatory policy leads to these businesses being termed 'informal' or 'smugglers.'

<b>Table 1: Employed Labor Force by Sectors (No. in millions)</b>						
<b>Industry/Sector</b>	<b>2001-02</b>			<b>2003-04</b>		
	<b>Total</b>	<b>Male</b>	<b>Female</b>	<b>Total</b>	<b>Male</b>	<b>Female</b>
Agriculture	16.37	12.69	3.68	17.97	13.22	4.75
Manufacturing & Mining	5.38	4.52	0.86	5.73	4.7	1.03
Construction	2.35	2.33	0.02	2.43	2.41	0.02
Wholesale & Retail trade	5.77	5.67	0.1	6.18	6.06	0.12
Transport	2.29	2.27	0.02	2.4	2.39	0.01

Financing & Insurance	0.35	0.34	0.01	0.44	0.43	0.01
Community & Social Services	6.03	5.04	0.99	6.27	5.15	1.12
Source: Labor Force Survey, 2003-04						

The upshot is that we have a very poor domestic commercial sector that can hardly serve the consumer. We have no department stores, shopping malls, supermarkets, chain stores, branch networks, leisure industry, brand names, city centres, warehousing, storage, or community and public spaces of any significance. Shops continue to be little boxes in dusty streets or corridors with no access. They have no inventory, carry no quality goods and warranties and consumer protection is unknown. There are hardly any businesses based on domestic commerce listed on the stock exchange. Their access to financial markets has always been limited in our history.

The declaration of commercial space is arbitrary. For example, the area around all hotels in Lahore, Rawalpindi and Islamabad remains basically undeveloped because zoning is changed for each individual plot of land and not for an entire area. In other countries such space is used for clustering commerce.

The history of retail is shown in table 3 below. As argued above retail is the front end of the market and a developing retail market will allow many upstream industries to be developed. But for that to happen, openness of the economy must be increased and maintained while also developing the legal and financial markets. It seems to me that Pakistan is still at the first or second stage of development. To move it along to the following stages, a change in the current policy mindset is seriously needed.

<b>Table 2: Share of Services Sector in Gross Domestic Product (At Constant Factor Cost – Percent)</b>						
<b>Industry/Sector</b>	<b>1969-70</b>	<b>2000-01</b>	<b>2001-02</b>	<b>2002-03</b>	<b>2003-04</b>	<b>2004-05</b>
<b>Services Sector</b>	<b>38.4</b>	<b>51.8</b>	<b>52.7</b>	<b>52.9</b>	<b>52.6</b>	<b>52.4</b>
Transport, Storage and Communication	6.3	11.7	11.5	11.5	11.4	11.1
Wholesale and Retail Trade	13.8	18.1	18	18.2	18.5	19.1
Finance and Insurance	1.8	3.1	3.6	3.3	3.3	3.7
Ownership of Dwellings	3.4	3.2	3.2	3.2	3.1	2.9
Public Administration & Defense	6.4	6.3	6.5	6.7	6.5	6

Other Services	6.7	9.4	9.9	10	9.9	9.6
GDP (Constant Factor Cost)	100	100	100	100	100	100
Source: Economic Adviser's Wing, Finance Division						

### **Moving the paradigm**

Our growth paradigm remains producer and export focussed and is based on government domination of the market. If the consumer was to be served and the domestic commerce sector were to develop that would necessarily mean the development of the market place and a retreat of government and the power of the bureaucracy.

Humayun Akhtar, the Minister of Commerce has agreed to the new agenda of looking towards the development of the domestic commerce sector. He has

- Commissioned a large study of this sector.
- Hosted this conference.
- Has agreed to restructure the MOC to meet this new challenge.
- Has initiated a deep institutional change at the MOC where from 2007 onward there will be a State of Commerce report that will be issued by the MOC telling us what the state and nature of markets is in Pakistan.

It is an ambitious agenda. Let us wish him the best in leading this agenda!

These changes will mean

- MOC which till now has been focussing mainly on export promotion will now be concerning itself with “*promoting successful business through encouraging trade, entrepreneurship and innovation and providing fair and efficient markets for the welfare of all Pakistan.*”
- MOC will become the **guardian of openness and competition in Pakistan**—a mandate that seems natural for the ministry of commerce.
- Trade policy will no longer be only for promoting exports but for promoting all trade both at home and abroad.
- MOC will have to lead the deregulation effort in the country to unleash the power of the market.

It should be our hope that this effort at modernising the MOC will be supported by all—the government, the people and the donor. If this ministry truly is able to accomplish this agenda, it will greatly develop sound economic governance in Pakistan.

## **Conclusion**

So next time you talk of trade, please remember domestic commerce. It is my contention that if we truly unleash this sector, we will not only significantly increase our growth but also develop a more egalitarian and just society.

People ask too often what policy are you recommending. My answer always is that I need to understand before I can even think of a policy intervention. Basically, economists recognize that we need to study a situation, an economy or a market before you even think of policy. Only if in the course of researching the situation, you discover an intervention that could improve welfare that you call that intervention a policy. We are too loose with the term 'policy.' Non-expert committees comprised of part time members with no research backup come up with policy recommendations in few sittings. Even foreign consultants make policies in a matter of a couple of weeks in an Islamabad hotel. Too often policy is mistaken for government projects. The sustained research that built American regulation and then deregulation, or the European welfare system, or the European unions, or the East Asian Miracle is just not there.

It is for this reason that Minister Humayun Akhtar has agreed to conduct extensive research regularly on domestic and external commerce. Based on this research, MOC will publish an annual report on the State of Commerce. And our expectation is that this research will allow us to develop a better framework for developing domestic commerce.

Nevertheless, even casual empiricism does suggest to us that the policy conclusions that will emerge will involve a substantial degree of deregulation. In particular our outmoded and anti-commercial zoning policies that pervade our city management will have to change. As will the government's attitude to continued ownership of vast tracts of city centre land which could be better used for commercial development.

To sum up, in my view the new trade policy must also unshackle domestic commerce while also continuing to open out the economy. Let markets develop, push back

regulation including outmoded urban zoning and develop technical expertise to meet with the challenges of the open market economy. It must develop a greater consumer focus and maintain a level playing field for all forms of economic activity. It must seek to increasingly integrate Pakistan into the global economy. It must have faith in our producers to compete without special privileges and concessions.

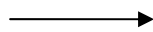
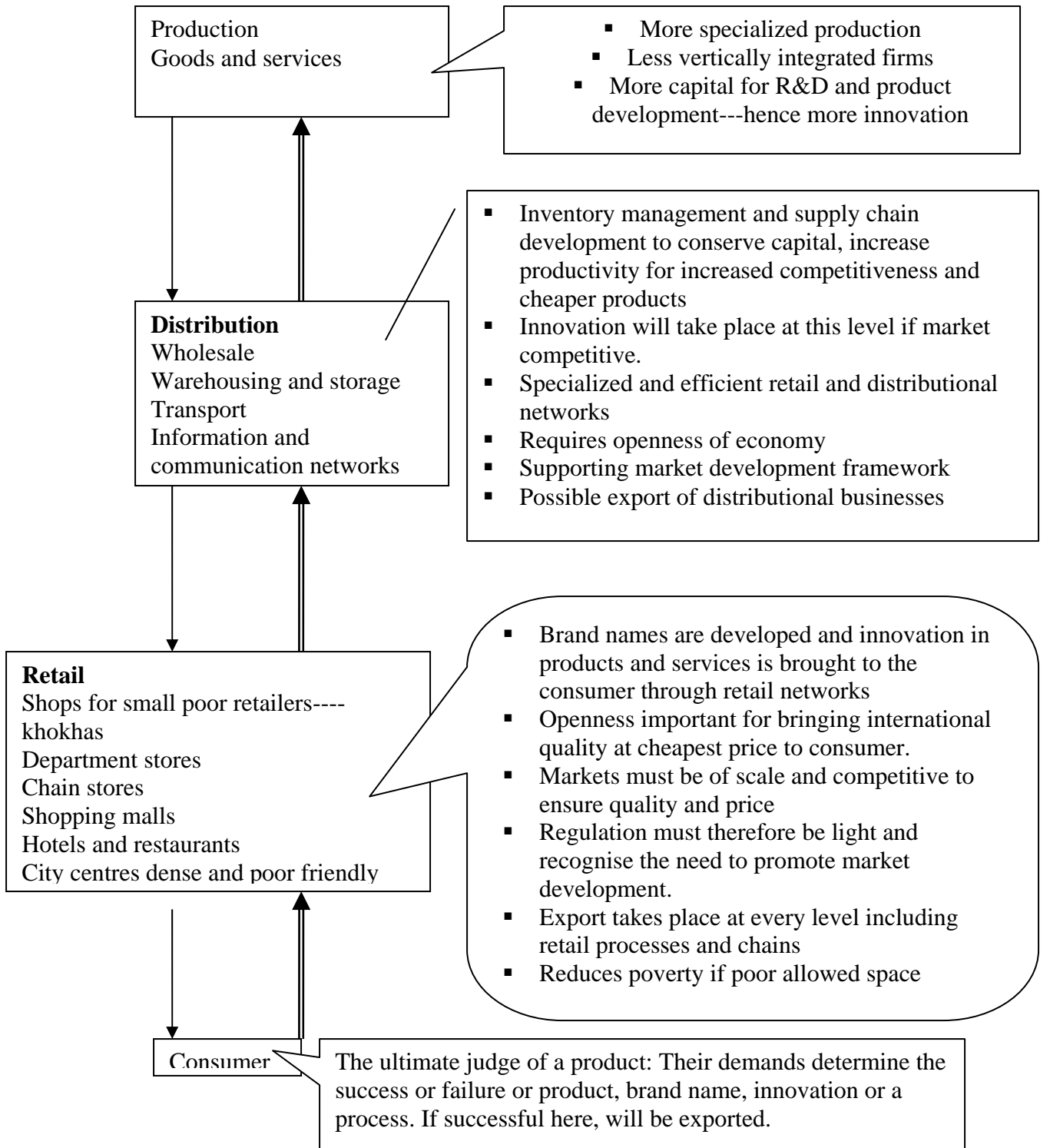
However, for this to happen, the government must step back and allow markets to develop!

**Table 3: Historical Development of Markets**

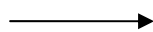
<b>Stage</b>	<b>Type</b>	<b>Characteristics</b>	<b>Upstream Infrastructure and Legal Needs</b>
First	Small shops along well traveled routes	Limited convenience, high margin, low turnover, limited inventory and high search costs, no consumer protection	Small manufacturers
Second	Supermarkets and shopping clusters especially markets of a similar good e.g. Diamond market, the clothing market etc.	Improvements in convenience, margin, turnover, inventory and search costs over first phase as more competition develops but still market participants lack financial strength to truly benefit consumers	Craft and small manufacture
Third	Department stores	Offering convenient one stop shopping, brand names that invest in quality & consumer protection. Low search costs as department store maintains large inventories.	Distribution, wholesale and warehouse activity. Professional management
Fourth	Chains of stores	Bringing the department store reliability and consumer benefits close to all consumers. Large turnovers with margins dropping	Growth in distribution, wholesale and warehouse activity. An open economy supplies this network. Supporting legal framework for long distance management and contracting
Fifth	Convenience stores and discount stores	Big companies with deep pockets using their buying power and marketing ability to do a high volume, high turnover, low margin business. Consumer welfare enhanced	Supporting financial markets and open economy that allows a global reach. Warehouse and distribution companies are large partners
Sixth	Shopping malls to house above activities	Increased convenience making shopping a pleasant experience	Development of institutional investors who invest in large physical investments such as shopping malls and financial and legal system that supports this form of specialized multi contracting business



**Chart 2: The Consumer Focussed Economy**



Indicates direction of flow of goods and services



Indicates flow of information on consumer demand and tastes

#### **IV. ISSUES**

These issues were handed out to the participants prior to the conference.

## **Issues that speakers should address**

This seminar brings together the key players in the arena of domestic commerce. Our continued preoccupation with the production/mercantilist paradigm has stifled domestic commerce. The questions below are intended to understand the state of domestic commerce and the factors hindering it. Conference participants, who are leaders in this field, should address some of these as well as point out other areas that constrain or help domestic commerce growth. The focus should be to understand how we can make this sector a leading sector in our country.

### **1. Is growth in this sector adequate?**

1.1. The pace of brand name development

Note: Historically brand names have been developed to indicate uniform quality and warranties to consumers!

1.2. The pace of branching or network development?

Note: Branching saves search costs and provides quality assurance!

1.3. Consolidation in the sector? Are large companies with branch networks developing? Pace of department store, specialty and mega store development

Note: Historically, small stores have consolidated into branch networks and department stores to pass on lower margins, lower search costs, better quality and protection to consumers!

1.4. How many companies from this sector are listed on the stock market? What is the growth in the number of listings?

Note: When growth opportunities are available, use of stock market for financing becomes critically important!

1.5. What are the factors constraining or helping growth?

### **2. State of market development.**

2.1. Competition at the retail and wholesale levels. Are prices equalized? How fast?

Note: When markets function well, prices must equalize fast across space!

- 2.2. Bottlenecks, market rigidities, and monopolies, if any? Why are they sustained?
- 2.3. Information availability about goods, vendors, inventories etc.

**3. The role of State in the provision of a framework for trade.**

- 3.1. Legal & Justice system?
- 3.2. Maintenance of law & order?

**4. Policy issues affecting this sector?**

- 4.1. Tax policy?
- 4.2. Tariff policy?
- 4.3. Regulation? Local, Provincial, Federal?
- 4.4. Urban zoning and availability of land and space?

Note: In most countries and through history cities have been configured for myriad of activities. City planners and zoners are sensitive to these needs and allow for them!

4.5. Consequently we need to ask ourselves,

Is there adequate space for retail (shopping malls), leisure (hotel, restaurant and others), office, warehousing, storage, and other such activities?

4.5.1. Is city administration friendly to commercial zoning such as large shopping malls, hotels etc.? Or is it only catering for housing?

4.5.2. Upstream and downstream linkages

4.5.2.1. How specialized is domestic commerce?

4.5.2.2. How competitive is each market?

Note: Retail is the front end of business activity. It has to be supported by competitive markets for wholesale, warehousing, real estate development, storage, and transport etc. growth takes place when specialization occurs in each of these businesses and capital is clearly allocated to core business!

**5. The state of consumer protection.**

- 5.1. Product quality
- 5.2. Warranties and returns
- 5.3. After-sales service?

## **6. State of market regulation.**

Note: Markets need regulation when there are issues of monopolistic practices, informational difficulties, or some clearly identified pathologies that interfere in the process of supply and demand determination. Regulation should be decreasing the cost of doing business and increasing market competition and growth. Regulation can be captured by the market or by the state to perform functions other than the promotion and development of the market!

- 6.1. Who are the regulators?
- 6.2. What is their regulatory objective?
- 6.3. How well do they perform their function? How competitive is the market?
- 6.4. Does the regulator enforce consumer protection?
- 6.5. How competent and independent are they?
- 6.6. Do we have a competition policy? Do we need one?
- 6.7. Do they lower or raise the cost of doing business?
- 6.8. Is the regulator captured?

**V. LIST OF PRESENTERS AND AGENDA**

## **SEMINAR ON “DOMESTIC COMMERCE – THE MISSING LINK”**

**Saturday, 28<sup>th</sup> January 2006 at Pearl Continental Hotel, Lahore**

### **SESSION 1**

**Chaired By:**

**Mr. Humayun Akhtar Khan**

Commerce Minister

**Keynote Address:**

**Why Domestic Commerce is the Missing Link? Dr. Nadeem Ul Haque, Trade Policy Advisor for the Ministry of Commerce**

### **Panel 1**

- a. From the standpoint of retail and real estate development: **Mr. Salman Taseer, Chairman World Call Communications.**
- b. The view of a large multination distributor: **Mr. T.A. Batlay, Director Colgate-Palmolive Pakistan Ltd.**
- c. Service one of the largest retail networks in the country: **Mr. Shahid Hussain, Chairman Service Group.**
- d. A major international investor just entering the market: **Mr. Marek Minkiewicz, Managing Director Makro.**

**Mr. Mahmood Akbar, Managing Director Salt n Pepper** - presentation was circulated.

### **SESSION 2**

**Chaired By:**

**Mr. Mian Mansha**

Chairman Muslim Commercial Bank

### **Panel 2**

- a. Developing a brand name and international presence: **Mr. Faisal Farooq, CEO Nirala Sweets**
- b. Development of a domestic brand name and a clothes retail chain: **Mr. Hamid Zaman, Managing Director Sefam Pvt. Ltd.**
- c. Agricultural marketing and wholesaling: **Mr. Mansour Arifeen, CEO Punjab Agrimarketing Company**
- d. **Mr. Sakib Sherani, Chief Economist ABN AMRO Bank Pakistan**

**Jalal Salahudin, Creative Director J&S<sup>3</sup>**- presentation on entertainment was circulated.

### **SESSION 3**

#### **Chaired By:**

**Dr. Salman Shah**

Advisor to the Prime Minister of Pakistan for Finance & Economic Affairs

#### **Discussed Issues**

1. A vision for the future of domestic commerce: Developing a consumer economy?
2. How open should the economy be?
3. What sort of a tax policy?
4. The role of regulation
5. Market development issues
6. Urban zoning issues

#### **Panel 3**

- a. **Dr. Faisal Bari**, Director Mehbub-UI-Haq Institute
- b. **Dr. Chaudhry Imran Ali**, Professor LUMS
- c. **Dr. Sohail Jehangir Malik**, Chairman Innovative Development Strategies
- d. **Dr. Ali Cheema**, Professor LUMS



## **VI. SUMMARY OF PRESENTATIONS**

## **1. GROWTH OF REAL ESTATE SECTOR AND ASSOCIATED PROBLEMS**

**Mr. Salman Taseer, Chairman World Call Communications, Pace Development**

The recent boom in the real estate, which favored a lot of investors and speculators, has not led to strong real estate development. The construction sector accounts for only 3.3% of our GDP, as compared to the 10 to 12 percent of GDP that other countries seem to average. Development of this sector will unleash economic growth, create jobs and generate economic activities in more than 40 allied industries. Even though things are beginning to happen, we remain very far behind in terms of commercial sector development. In particular, we lack shopping malls, office space and hotel development.

While investors and speculators have benefited from the boom, the average person genuinely interested in buying and constructing a house is unable to do so because of the hike in prices. Even if he is able to secure a housing loan, the cost of land bars him from being able to purchase land for construction. This has hurt housing sector development in a big way. Although the banking sector is financing housing in good proportions yet mark-up costs have gone up due to the strict monetary policy being followed by the State Bank. This coupled with high prices of land have made it even impossible for a lower or middle class family to even finance their own dwelling.

Land acquisition for commercial purposes involves lengthy and difficult process, especially in cantonment areas of the country. If the land is leased a number of departments are involved in the transaction and even after winning the bid, the developers have to wait for a long time. The system of transfer of property apparently looks simple but the officials involved in the transfer have made it difficult, even a correct document is not entertained in LDA or revenue authorities without pleasing them. Speed money has now become a separate line of tax that is applicable to everyone who enters the office of a government authority for obtaining necessary approvals. Finally, the land records are not properly maintained, as a result of which there are instances of multiple ownership of the same establishment.

**Appropriate Measures**

- There should be an appropriate regulatory framework to encourage real estate development and punish fraud.
  - Speculative transactions based on files should be discouraged in future to avoid price hikes as recently witnessed in real estate sector.
  - Networks of fake housing schemes and builders are defrauding consumers. The government should have strict procedures in place to penalize/ punish such fraudulent parties.
  - Real estate agents and advisors who should be certified and trained and bound to provide true information and complete services.
  - Government should encourage structures such as REITs (Real Estate Investment Trusts) because these institutional players will allow a sound and secure development to take place.
  - Transfers of land should be made more transparent, less bureaucratic, a one window operation on modern lines to ensure accuracy and promptness and that laws pertaining to the approval of housing societies need revision.
- Economic planners will have to ensure that alongside the stable real estate prices, construction activity is also encouraged in a way that it is feasible to undertake.
- The land/ revenue records should be computerized on priority basis and real estate agents should not themselves be playing the market to introduce artificial price hikes.
- While talking of the housing sector, he mentioned initializing of subsidized housing schemes at affordable prices for the poor and even the middle classes.
- Facilitating investors for investment in this sector especially by relaxation in tax laws and reduction in registration fee and stamp duty.
- Encouragement of construction of multi-story apartment buildings and developing a legal framework for the common ownership and maintenance of these buildings.
- On the role of media, leading TV channels have no policies in place to ensure that they are not providing misinformation to the masses. Laws are being formulated

and improved but they are not being properly publicized so there needs to be general awareness for these laws.

- The government owns large tracts of land often for the housing of VIPs in city centers that should urgently be privatized to make room for commercial city centers.

## **2. EMERGING TRENDS AND CHALLENGES IN DOMESTIC COMMERCE**

**Mr. T.A. Batlay, Director Colgate-Palmolive Pakistan Ltd.**

### **Functioning of a Distributor and Budding Trends**

Small and big International wholesale and retail chains are entering the market along with companies providing transportation, warehousing and distribution facilities. However there are many challenges to the development of an efficient distribution industry.

- Principally supply chain bottlenecks could be substantially streamlined if a well-regulated transportation system and modern warehousing space were to be developed.
- Smuggling of goods again is a major hurdle to entry in retail. This arises from the lack of tax culture and poor documentation of trade and distribution.

### **Way Forward Proposal**

Keeping in view the changing global economy, Pakistan should take effective steps to further improve business-to-business interaction and enhance trade through further streamlining procedures, holding single country exhibitions and further development of a joint chambers of commerce and industry. A committee should be formulated to examine issues relating to trade and transit trade and should submit proposals on appropriate solutions. It is to be kept in mind that that changing global economic trends demand closer regional interaction.

- Transport and Warehousing to be declared an industry. Currently, cars seem to get a preference on roads and highways over the transport industry. Traffic rules and routing for the transport industry should be clarified while the condition of roads and highways is improved.
- Tax incentives for these industries, which through neglect are severely underdeveloped.
- A clear zoning and provision of warehouses and cold chain services.
- Documentation of trade and distribution that is

- Registration of distributors.
- Duty reduction on goods prone to smuggling.
- Record of professional logistic service providers.

### **3. CURRENT STATE OF DOMESTIC COMMERCE**

**Mr. Shahid Hussain, Chairman Servis Group**

#### **Company Structure**

- Servis is one of the largest retail networks in the country with 290 company managed outlets and 1500 dealers are being serviced from 14 regional offices. Its annual turnover in 2005 crossed Rs. 3.75 billion.
- It follows the total vertical integration model starting with procurement of raw materials, conversion into components, assembly of shoes and distribution to end consumer through our retail and wholesale network.
- Servis is also into 'Tire' business that is manufacturing of rubber tires and tubes for motorcycles and bicycles which are sold through 20 distributors within the country.
- It is now a policy to open 1 new store every week from 2007.
- Servis has gone into new ventures
  - 'Servaid' - Health and Beauty Care retailing.
  - 'Shoe Planet' - Self Service and multi brand shoe retailing chain.

#### **Trade as an ignored sector**

Domestic Trade is one of those sectors of Pakistan that has literally been without a patron for the longest time. Ministry of Commerce has in the past acted as the Ministry of Foreign Trade and Commerce only – failing to recognize the significance that volumes of domestic trade and commerce have for an economy and that in Pakistan.

There is no data availability about businesses and especially about retail and domestic commerce as it is handled mostly by informal sector. Retailing has gone through revolutionary changes with the advent of supermarkets, hypermarkets, malls and now the super malls. Selling through the internet has become the norm in the developed countries because of the convenience of transaction and ability to compare various aspects of the products.

## **Emergence of Global market in Asian region**

Till a few years back Pakistan's economy was protected through high tariff and other import restrictions. The commerce and industry structures and practices developed around such protection. The consumers were satisfied with the goods and the manner in which these were presented to them due to lack of exposure to developed markets. With in a few years the tariffs have come down, consumer awareness has increased due to modern communication, foreign multi-nationals and their products, and the emergence of a global market in the Asian region as a whole.

In Pakistan retail shops are undersized, thereby limiting the display/servicing area. A comparison can be made here with the rest of the world. The concept of "Mall World" is spreading rapidly even in developing countries like China, Thailand and Turkey. USA is the most "Malled Nation" with 20.2 square ft of Mall space per capita. There is a new wave of mega-malls coming up in countries like China, Taiwan, and Argentina etc. The size of these malls is running into hundreds of thousands of Sq. meters. Pakistan remains far from this development.

### **What the sector lacks?**

Servis is one of the largest retail networks in the country with an annual turn over of more than Rs. 3.75 Billion but is subject to great challenges.

- It has to remain vertically integrated because support infrastructure – Contractors, Logistic Companies, Middle Management etc. – is unavailable. This results in sluggish growth.
- Also the sales tax and income tax policies are inconsistently applied and there is no copyright protection available. It requires entrepreneurs' personal effort and money to trace our counterfeit manufacturers and this practice seldom has successful outcomes.
- Businesses are not allowed to flourish properly due to negative influence of wholesale channel in promoting non-branded and inferior products in an effort to improve their income.



- There is inappropriate logistic support and lack of availability of professional distributors.
- Smuggled/ under invoiced imported goods act as a hindrance in improving/maintaining market share of big entrepreneurs.

#### **4. PROBLEMS OF A MAJOR INTERNATIONAL INVESTOR**

**Mr. Marek Minkiewicz, Managing Director Makro.**

##### **Organizational Structure**

'Makro Cash and Carry' is a joint venture of SHV (70%) and House of Habib (30%) and already has 184 stores world wide in countries like China, Malaysia, Columbia, Brazil, Philippines etcetera. The economic benefits it brings to Pakistan include foreign investment of at least \$150 million, grading and modernization of supply chain of farm products, employment of 4000 personal (20 wholesale centers), wholesale cash & carry pricing for customers, new supply system for retail traders, export of farm and food products and modern documented wholesale trade centers. Makro concept is simple in essence, its target customers are small retailers, services and bulk users and it promises volume sales with low margins, prices lowest among competitors, and high standards of hygiene on product handling.

##### **Issues affecting Modern Trade**

There is an excellent cooperation with the local partners and no barriers between their communication and staff general competence and loyalty are seen as a positive attitude of the Pakistani labor market. There are various very important issues that are affecting modern trade in Pakistan. These included positive Government support at upper levels where as such sources are not always visible at the working level. Modern retail/distribution training is done internally. Affordable and available land is one of the biggest problems affecting modern trade. Not only are the land prices very high but there are also high hidden costs associated with land acquisition such as tax for just registering transfer, commercialization charges, lawyer costs etc. per land title transfer. There is no policy of LDA of converting industrial into commercial usage, no clear footprint guidelines available and no clear zoning concept supporting modern retail development. Many government agencies (Railways, CAA, Army, KPT, Sindh/Punjab Government, Education department) have land that is not fully utilized or vacant but do not have a clear policy how to sell or lease it. When considering sale/lease of land main

consideration is present revenue, not general economical development and progress. Inequitable tax laws pose another of the big problems. The aim of the government should be to create a level playing field to enable open competition, which will benefit the end consumer with low prices.

## **5. RESTAURANTS AND LEISURE**

**Mr. Mahmood Akbar, Managing Director Salt n Pepper**

### **Improving the Entertainment Industry**

The government can contribute a lot to improve the state of hotels, restaurants, banquet halls, caterers and other such service providers.

- Confusion exists regarding restaurants status as an industry whereas this should not be the case. They should not only be declared as an industry but also given all the benefits as such.
- Sales tax percentage may be reduced to 5 to 8% to encourage people to pay more sales tax and to declare their sales accurately.
- Similarly, financing and loan facilities should be extended to the restaurant business for new operations and for renovations/ expansions and this should be from Government Banks at reasonable rate of interest.
- There are too many Government agencies involved in various controls of the restaurant sector. This should be streamlined and lesser amount of agencies should be given control. Pure Food Ordinance is very old and outdated. This should be reviewed urgently.
- Security for foreign tourists should be enhanced and the media must propagate Pakistan as a safe and progressive country. The country has a lot of potential for foreign travelers and tourists.
- Fundamentalism must not be allowed to affect this important industry.
- Tourism information should be easily available and constantly updated through websites for travelers who wish to visit Pakistan.
- More cultural events to present a soft picture of our society and on improvement of infrastructure and transportation facilities must be developed.

- Embassies should help create awareness through presentations about Pakistan and the Tourism Ministry should work on the similar lines as that of other South Asian countries.
- Food should be allowed to be served on wedding and wedding related functions.
- Banquet halls and Caterers should also be formally recognized and given status of an industry.
- The leisure industry is seriously underdeveloped. There are no theme parks and different sporting and healthy activities to provide quality entertainment to the general public.

## **6. DEVELOPING A BRAND NAME & INTERNATIONAL PRESENCE**

**Mr. Faisal Farooq, CEO Nirala Sweets.**

### **Company History**

'Nirala' started as a Halwa purri (Breakfast) shop from a capital base of Rs.200 with the human resource of only 2 individuals in 1948 later adding 'Mithai' in the product range in the early 1970s. The business pretty much remained stagnant till the 1990s but gained momentum after the opening of first national outlet outside Lahore in 1999. Today however it's a different story altogether. It makes dairy products in addition to sweets, and successfully runs a restaurant employing more than 650 people. It has 35 branches in Pakistan and currently exports to Sharjah, Dubai, Canada, Europe and USA. It has in-house design and software concerns rendering services to various other companies and stands tall in an environment where no industry standards are available.

### **Difficulties faced during Growth**

A lot of effort and hard work goes into developing a reputation and same has been the case with Nirala:

- They faced a lot of problems during their growth such as lack of trained and educated human resource.
- They were also subject to a lot of infrastructural bottlenecks such as there was lack of development of channel partners, transportation infrastructure and legislation barriers and limitations.
- Also it is a well-known fact that the financial system in our country is such that acquisition of capital is an arduous procedure so the founders of Nirala also had to cope up with the limited interest of financial institutions.
- In addition to that there was lack of R&D facilities and lack of market information data, which added to the existing challenges of developing a brand name.

Domestic Commerce is very important and vibrant sector of the economy and the Government can play a key role in strengthening of this long forgotten sector.

## **7. IMPORTANCE OF BRAND NAME**

**Mr. Hamid Zaman, Managing Director Sefam Pvt. Ltd.**

### **Importance of Brand Name**

Due to increasing strength of competition in the market, companies have adopted advanced marketing and advertising techniques to persuade the consumers. There are many factors that play an important role in the different behaviors of consumers regarding shopping. One of those is 'Brand Name Acquisition' although there are a lot of other factors as well such as influence of family, cultural environment, role of marketing and advertising etcetera. For some the brand name or the basic information advertised about a product is a factor that influences to purchase that product. For instance, if a famous brand introduces new cosmetics, women will take time to purchase it no matter how expensive it is, if it is her favorite brand. Similarly for those who are not brand conscious, they just go for what they feel comfortable to wear or what suits their personality best. Now branding can be of two types:

- Product Branding
- Store Branding

As the name suggests, the first is branding of a particular product, which can be sold in a large number of stores such as YSL perfumes while store branding is where the stores sell products only from their own brand such as Bareeze.

Ultimately only brands will survive since they offer people quality products and eventually it is quality of product that matters the most to any consumer. If we are to move from being providers of raw materials at lowest profit margins to suppliers of value-added goods with high profit margins, local brand names must be developed. Traditionally, strong brands developed locally in markets where consumer preferences can be expressed and market information is readily available. We need to develop local markets for strong brand competition, raise local quality awareness, undertake better

selling practices so that our companies improve their products, services, man power training and become competitive internationally.

Requirements for developing brand names are

- Superior quality of products,
- Sustained maintenance and continuous improvement in quality,
- Constant innovation and development,
- Improved selling practices and return policies and last but not the least
- Uniformity of prices, inventory and selling techniques.

### **How can Government facilitate this sector?**

Government is the key player in improving the domestic commerce sector in any country and the most immediate step of the Government should be enforcement of Intellectual Property and copyright laws. Seen as an incentive to benefit the public, these rights in particular have sometimes promoted innovation by ensuring that someone who devoted, say, ten years of penury while struggling to develop vulcanized rubber or a workable steamship, could recoup his investment of time and energy. Using monopoly power, the inventor could exact a fee from those who wanted to make copies of his invention. Without intellectual property protection, incentives to engage in certain types of creative endeavors would be weakened.

Similarly, such policies should be formulated, upgraded or promoted that encourage the retailers to grow bigger by rewarding them rather than punishing them with unnecessary tax burdens, infrastructural constraints etcetera.

Steps need to be taken in order to stop the smuggling and sale of foreign goods because this is the only way the Government will give room to the local industry to flourish.



## **8. AGRIBUSINESS**

**Mr. Mansour Arifeen, CEO Punjab Agrimarketing Company**

Commerce in agricultural commodities has been a neglected sector. It is a large and complex sector, which needs to be better understood. For its development, it needs resources in terms of finance and infrastructure. Neither the government nor the business sector has begun to think about the complex arrangements that will need to be put in place if agribusiness is to grow.

Rapidly changing social structures around the world have necessitated fundamental changes in the way in which goods are being presented and traded. This will require a substantial investment.

To facilitate the development of agribusiness, banks will have to become sensitive to the needs of this industry. To date banks are not very receptive to the financing needs of agribusiness inhibiting development. A lot of finance will be required for local brand name development. Currently local brand name development is hindered by the presence of the multinational companies which have massive financial support for production and distribution where as local companies do not have that kind of financial support. When multinationals enter the market they take over the local companies that had been struggling to come up over time. Take the example of 'Polka Ice-cream' which was quite a big name in Pakistan a decade ago but is completely gone today because of multinationals like Walls.

The bottom point was that brand development requires high volumes of capital. Government policies should be supportive and protective of such infant industries as agribusiness.

For agribusiness to take off, we will need a healthy domestic commerce sector including retail, wholesale, warehousing, transport, and distribution. Government has to play a key role in improving and protecting domestic industry. A lot of financial resources, architectural expertise, building and other logistic support for a healthy growth in retail sector will be needed.

## 9. FINANCE & COMMERCE

### Mr. Sakib Sherani, Chief Economist ABN AMRO Bank

The outstanding stock of bank credit availed by the private sector in Pakistan has witnessed an increase over the past few years, rising from approx. 22% five years ago, to nearly 27% of GDP by end of FY05. This increase represents greater access to formal bank credit by the non-government sector in Pakistan – a trend especially welcomed given financial repression and the consequent crowding out of the private sector till around the end of the 1990s. A higher use of bank credit by the private sector is also associated with a greater degree of financial and economic development.

While the use of bank credit by the private sector remains low as a % of GDP in Pakistan as compared to its regional “peers”, with the corresponding figure for India at around 40%, Philippines approx. 50%, and Malaysia at 140% of GDP, there is some cause for optimism in terms of both the recent trend, as well as the sectoral composition of bank credit usage. In terms of *trend*, over the past 3 years bank credit to the non-government sector has increased at an annual average of around 30-35%, or roughly at twice the rate of nominal GDP growth. (By way of comparison, however, in India the rate of growth of bank credit to the non-government t sector over the same period is closer to 3 times the rate of nominal GDP growth).

In terms of sectoral composition, while credit to SMEs and Agriculture has shown healthy rates of growth over the past two years, the share of these traditionally-under serviced sectors in overall credit has remained either static, or declined modestly. The biggest gainer is *consumer finance*, which has increased its share of bank credit by five percentage points in two years, to 11.5% of total as of end FY05.

However, if one we are to map the sources of value-addition in the economy to the use of bank credit, the obvious conclusion is that large scale manufacturing sector (“corporates”) avails bank credit roughly in line with its overall share of GDP, while Agriculture & SMEs – representing a combined roughly 60% of GDP according to official statistics – are grossly under-serviced, getting approx. 7% of total credit from the financial system.

The obvious question that flows from the foregoing discussion is: why have banks not provided credit to 2 of the largest sectors of the economy?

This brings the role of the government and the absence of a robust and viable institutional framework into focus. It is an issue that has been talked about in the context of credit to SMEs, but mostly in terms of specific regulations or interventions. The more fundamental question is:

“Can small businesses really become ‘bankable’ in a weak institutional setting?”

The government obviously exerts a very large influence, whether directly or indirectly, on a lot of issues facing businesses. For example, while the government’s share of bank credit has declined over the years, it is still a very large user of credit, with its outstanding stock of loans from the banking system equivalent to 11% of FY05 GDP. In addition, the government’s inability or unwillingness to properly document the economy, or to raise the tax-to-GDP ratio by taxing its constituents, places a disproportionate burden on the formal sector, while maintaining an insatiable appetite for bank financing on the part of the government.

Similarly, both the tax policy as well as the monetary policy in place over the past three years at least, provide strong disincentives to financial savings. While monetary policy has led to negative real rates of returns to depositors, under our tax laws interest income on deposits is taxed, while capital gains on equities or real estate transactions is tax-exempt.

This issue gains importance when viewed in light of the fact that the savings rate is low in Pakistan, while financial savings is even lower, at approx. 50% of total savings.

Incidentally, the last point highlights the role of banks and places some culpability on them – have banks done a good job at financial intermediation when both financial savings as well as outreach of bank credit are so low?

In terms of increasing outreach, commercial banks have finally begun to take the first steps in putting the infrastructure and resources in place. However, to make 60% or more of the economy “bankable”, the role of governance is critical. The government has to strengthen the financial institutional framework by providing, among other things:

- A strong judicial system.

- Ensuring international accounting standards.
- Regulatory capability.
- Tougher foreclosure laws.
- Formal bankruptcy procedures.

### **Agenda for further research**

- 1) Can the SME sector, particularly in manufacturing, survive the onslaught of global as well as regional competition?
- 2) What will the potential impact of Basel II standards on bank behavior?

## **10. SIGNIFICANCE OF HOSPITALITY AND ENTERTAINMENT AS AN INDUSTRY**

**Mr. Jalal Salahuddin, Creative Director J&S<sup>3</sup>**

In the developed world today and especially in the developing world there is a silent revolution taking place that is creating more opportunities for individuals than ever before. The last two decades of the last century and first half decade of this century have seen the highest growth in numbers of the global middle class ever in human history. This revolution is an evolving process that is the culmination of a variety of factors. Huge changes in science and technology have fueled this revolution. The democratization of finance has made jobs, credit, and easy money available for tens of millions of people. Microsoft can now pay an Indian employee sitting in Bangalore for providing a service to an American customer sitting in Santa Fe. The Microsoft employee can use this credit card to purchase a variety of goods and services ranging from a cup of coffee at Barista to a concert ticket to the upcoming Bryan Adams tour to an aromatherapy massage at the Taj Hotel spa all in one afternoon. And what makes him want to buy these particular goods and services and not others? Because he aspires to be part of a greater middleclass that through their increasing financial independence want to be able to buy themselves a lifestyle that is cosmopolitan and knows no geographic borders.

This aspirational lifestyle has been fueled by the knowledge revolution – people sitting in Pakistan watch Sex and the City on HBO and imagine (if not really experience) what it is like to live as a single young person in New York. They can get tips on where to eat, sleep, shop, and party from Bangkok to Belize at a click of button. They can also at click of a button buy an air ticket and fly to Dubai on a low cost carrier for the weekend. Satellite TV, cable and the internet are the tools that enable people to do this. They enable a designer sitting in Lahore to design a collection of clothes inspired by Gucci or Roberto Cavalli and influence the way women dress in our country when this fashion show is aired on Fashion TV Pakistan. The conflux of influences and linkages is incredible and awesome. What we aspire to have is more choices: personal, professional and economic. And choices make us happy. Therefore there is a deep philosophical desire underpinning

all this and that is the ability to create an atmosphere that makes individuals and society as a whole more happy.

When we talk of domestic commerce and if our city planning and zoning laws are in place for the retail sector to grow or for large hotels to come up, or whether specific taxes are helping local businesses or whether regulation is decreasing the cost of doing business we need to go back to the reason why all of this is being discussed at this forum today. The time has come in many developing societies across the world to open up. No government or individual can stop people for aspiring to a better life style. Science and technology and its myriad effects in all areas of life have opened up the eyes of billions of people to the rest of the world. Governments, institutions and leaders can only choose to make the transition towards creating a modern economy easier or more difficult. At this forum we are gathered here to see how we can make this crucial transition easier.

This means building the right environment for all those actors that want to create choices for the Pakistani consumer so that they thrive, specialize and help build a sophisticated modern culture. Policies have to make the cost of doing business cheaper for those businesses previously not recognized as 'serious' or 'income generating' or 'export oriented'. This means that state actors and the world of Pakistani finance needs to think out of the box and take all players from different walks of life seriously so that small businesses can grow and one day become brand names not just in Pakistan, but South Asia, Asia and perhaps even the rest of the world. Today the modern media gives us more chances to be able to build brand name for a good or service locally, regionally and globally. The success and strength of a society today and in the coming decades will not be measures by how many bombs or guns they have but how many global brands they have produced and by the appeal and international reach of their 'soft power' through the films that they make, the culture they produce in their cities and the universal values that make the society special.

### **Event Management and its Growth**

In the business of event management, entertainment, experiential marketing, 360 degree brand communication etcetera J&S<sup>3</sup> has grown with no initial investment and grown exponentially in four years because people have founded a real need for such services.

Many years of conservative thinking has previously led Pakistani regimes not to give precedence to the business of hospitality and entertainment whereas today the global hospitality and entertainment industry is the largest industry in the world and is one of the fastest growing areas of businesses. Cheap airfares, great hotels, and brilliant marketing have increased the demand for wanderlust. People travel today more than ever before. More people visit India to see the beauty of Rajasthan and go to a Bollywood club night in Mumbai than fly in to India for business. Today Europeans are choosing the high end hotels, pristine beaches and favorably priced holiday packages of Dubai over skiing in France or sunbathing in the Costa del Sol. This is a testament to these countries and cities that have created the right environment that makes people visit them again and again. Entertainment in Pakistan has taken the shape of events primarily because there are very few options left for people where they can enjoy themselves and spend money. Events are a great business and truly value added- we hire everybody from carpenters to tent makers to caterer, florists and printers all in one go. The business is a nexus for all sorts of 'other' small and medium size businesses. More and more brands hire their services to give them creative below the line solutions for their brand communication. But with vision things can be taken further that is to create an environment where the areas like hospitality, entertainment and experiential marketing are given the support and encouragement to grow, develop and shine and that small businesses of today become the aspirational brands of tomorrow and have the ephemeral quality in people's minds that can never die but continuously evolve to delight and capture the imagination of the next generation.

**VII. SESSION CHAIRMEN'S CLOSING REMARKS**



## **MR. HAMAYUN AKHTAR, MINISTER FOR COMMERCE**

He agreed to the fact that Pakistan has not been able to develop brands, motels, real estate, communication and leisure services despite the fact that 50% of the economy depends on such 'Services' and it in the past has been one of the most ignored areas. He pointed out that now improvements are being made and Services' provision is progressing. Also that the growth in this sector will make our country more competitive which in turn will lead to higher exports, higher GDP growth along with a healthy improvement in employment and a decline in poverty.

Our markets are being liberalized and the ministry of commerce is very impressive in trade diplomacy. However to make use of globalization, we have to prepare ourselves by focusing on domestic commerce growth. It is for this reason that he has initiated a major new effort at the Ministry --the annual report on the *State of Commerce* that will keep this sector under public and government scrutiny. Through this activity, we will understand this sector, develop data and information on it and finally be able to develop an enabling framework for it.

While we are focusing on obtaining FDI we should also be looking at what will facilitate local businesses.

To achieve all this more brainstorming like this conference is required. We also need to improve the technocratic edge of our government by inducting more qualified and technically capable people into government. It is through this dialog and infusion of fresh human capital that we will be able to formulate new policies and initiatives such as our fresh effort at revitalizing domestic commerce.

**MR. MANSHA, CHAIRMAN MCB**

He was of the view that domestic commerce and industry could take off if appropriate improvements in domestic governance could be made. In particular if the legal and judicial system could be improved to make speedy enforcement of contracts and quick dispensation of justice, the business could have a good framework to work in. This would require some legal changes but a lot of administrative changes in judicial procedures. But those would be well worthwhile given the pay off in growth that is possible.

Banking and financial reform had achieved a healthy financial sector that we can all be proud of. However, the banking sector cannot take the responsibility of developing the economy. In some cases even the prudential regulation system made it difficult for them to lend. For this reason, most small entrepreneurs feel that they are being discriminated against. But when you think about it, no banker would pass up an opportunity to lend to a promising business. Rest assured that banks are very sensitive to making money and will do everything to lend to promising enterprises but within the framework of prudential regulation and bank management. What needs to be understood is why small businessmen continue to look towards banks? Why do they not seek alternative financing instruments?

**DR. SALMAN SHAH, ADVISOR TO THE PRIME MINISTER ON FINANCE**

He said that the poor development of domestic markets, market fragmentation, limited buyers and suppliers in some areas and a serious lack of information in most cases was a major hindrance in the growth of the economy. While the economy was doing well, it could do even better if some of these problems were solved and a more commerce friendly environment was created.

There is a serious lack of information on domestic markets. He was happy to hear that commerce had commissioned some studies in this area and was preparing to do an annual report on the *State of Commerce*.

The Government had already commissioned a number of studies on growth and competitiveness, retailing, trucking and logistics, land markets, value chain studies in agro and non-agro based sectors. These studies had highlighted issues of market under-development and heavy handed regulation with rules that stifle markets. As a result, the Government was considering a Cabinet Committee to take quick decisions on these issues.

## **VIII. ANALYSIS OF ECONOMISTS**

The final panel comprised of 4 academics who summarized the proceedings in the following manner.

**DR. FAISAL BARI, DIRECTOR MAHBUB UL HAQ INSTITUTE AND  
PROFESSOR LUMS**

Importance of understanding domestic commerce came out clearly as most people thought that smooth functioning domestic commerce was a pre-requisite for greater employment generation, dealing with poverty and extreme inequality issues, and for efficiency (necessary for being able to survive in a globalized and liberalized world) gains.

A lot of people thought that it would not be possible to sustain a high growth level and maintain a high growth path if we do not address the internal commerce issues, especially in certain sectors. The background issues that were identified, where not enough work had been done, and research or further research is needed were:

- 1) Land markets, especially in urban areas. And the accompanying issues of rules for construction, occupancy and so on.
- 2) Taxation structure and the distortionary impact it is having on businesses due to exceptions, varying rates, and holes in the tax net.
- 3) Weaknesses in contract enforcement and judicial processes.
- 4) Weaknesses in the regulatory structure and in the organizations and institutions working in the area.
- 5) Lack of research on consumer protection issues and lack of implementation of existing laws.
- 6) Effects of globalization and WTO on all sectors.
- 7) In terms of sectors, wholesale, retail, transportation, warehousing (storage) and urban planning were identified as areas where we have almost no research and where problems are such that they are really holding back further development of businesses.

There are some broader issues that need to be tackled as well.

- a) Why do we not see development of large players in sectors like retail, wholesale, storage and transport? Why does it take a foreign player to enter the market before domestic firms can venture into the area?
- b) Where are the missing links in the various sectors that are holding local entrepreneurs back?

This is important to address as clearly with increasing globalization, integration in world markets, liberalization and privatization, our ability to export and even compete in local markets will depend crucially on our ability to lower transaction costs of businesses in domestic markets. Only if it is optimal for local businesses to expand will they invest in their business. And without economies of scale and creation of brand names it is hard to see how domestic business will grow and be able to compete globally.

This panel's solution to deal with the domestic commerce problems is commissioning of research so that we become aware of various trends in this industry such as why is that 80% of enterprises in our country are standalone etcetera. They pointed out various issues such as provision of affordable land, urban zoning problems, taxation structures and their lack of transparency, lack of knowledge about transportation, warehousing and whole sailing, and restrictions on sky scrappers' etcetera. They pointed out that for efficiency gains; the ability to compete is very poor. There are retail clusters all around the country so we need to look at our institutional strategy that promotes sub divided smaller shops rather than bigger malls and partnerships. We need to enforce IPR's and see whether political economy is geared against business development or constraining it.

They pointed out the fact that the role of regulatory authorities to ensure product quality is not that strong. This is why the market is flooded with a number of "me too" products. Consumer awareness pertaining to warranties and returns is mostly misused by the trade channel. Although consumers are charged the cost of after sales services, once goods are sold companies try to wriggle out of their commitment. Local/city governments need to be more sensitive to the need of new businesses and should rationalize their by-laws to reduce business costs. Towards such reduction of business costs, the issues of site plan approval, installation of commercial meters, sewerage lines etc should be improved as they are currently a headache for small businesses. If the outlook and perceptions of

domestic trade and commerce is not changed then this area will be consumed and overridden by the multinational corporations, who are always knocking at the doors of all emerging markets in the developing world (Pakistan being one of them). We are an emerging market, and our domestic trade and commerce sector should work towards participating and competing in that global market, and not be swallowed whole by mass consumption, production and distribution.

### **Mandate for new policy**

- Invest in Technology.
- Promote Innovation.
- Develop new market strategies.
- Specialization.
- Transparency.
- Quality Control.
- Decision making based on Research.

Finally, I congratulate Nadeem Ul Haque for introducing this topic into the policy debate and the minister of commerce for being quick to see value in the idea. I hope that enough resources are being injected into the project for us to have a good understanding of this important sector.

## **DR. ALI CHEEMA, PROFESSOR LUMS**

Policy research around issues related to domestic commerce is an extremely welcome agenda for a number of reasons connected to changes in the national and global economy. The Pakistani economy over the past 25 years has seen two major transitions. The first is a rapid rise in urbanization. A comparison of the 1998 and 1981 Population Census suggests that the share of urban population, defined as a population agglomeration of more than 5000 people, has increased from 23.9% of population to 43%. The other big transition that is occurring within this growing urban population is the rising importance of service sector employment. A comparison of the last two population censuses reveals that while agriculture's share in urban employment has remained stagnant the employment share of manufacturing, mining and quarrying has declined from 18.6% to 11%. As opposed to this the share of the service sector in total employment has increased from 65.4% in 1981 to 72.7% in 1998. These changes point to the emergence of an economy that is no longer built around rural agriculture or manufacturing and where very different needs are emerging regarding land use and living habits. It is also clear that the rising pattern of urbanization is resulting in an increasing need for infrastructure, commercial and social services. Furthermore, urbanization is bringing about a change in the nature of the type of services being demanded and will require a dynamic local commercial sector to cater to its needs. These findings suggest that researching the constraints to the emergence of a dynamic, consumer driven and scaled up commerce sector is, indeed, the need of the moment at this juncture of Pakistan's economic development.

The need to research the constraints to the development of the commerce sector become even more important with the recognition that Pakistan's existing commerce infrastructure is fragmented, small scale, low value added and highly uncompetitive. It is certainly not innovative and dynamic. The stagnant structure of Pakistan's commerce infrastructure becomes even more worrying and perplexing because globally the technological and product innovation frontier associated with this infrastructure has been shifting out extremely rapidly. Indeed, one need not look any further than countries like



Dubai and parts of India to appreciate the gains that are possible by adopting technologies that help put a country's service and commerce sectors on a dynamic path.

In spite of the importance of this sector for Pakistan it remains highly under researched and as a result we really don't have a good understanding of what is constraining it from emerging as a competitive and dynamic sector. The existing research around this issue suffers from weaknesses in explanation and errors of omission. The existing research largely aims to explain the stagnant path of the commerce sector in Pakistan through a combination of weak property rights, weak contract enforcement mechanisms and transaction costs associated with government agencies. However, even a rudimentary look at the Chinese economy with extremely weak property rights, weak contract enforcement mechanisms and high transaction costs associated with government agencies makes one realize that at best the existing explanations may be part right and may, in fact, not be able to explain the stagnation at all. Furthermore, the existing research is thin on analyzing the 'incentive effects' stemming from existing market structures and regulatory rules as possible determinants of stagnation. This is a glaring omission in the existing research. The weaknesses associated with the existing literature and the errors of omission clearly point to the need for building a solid research agenda that can help Pakistan's policymakers institute incentive structures that lay the foundation for the emergence of a dynamic commercial sector in the country. Nadeem Ul Haque is catalyzing some research on these issues and the Ministry of Commerce is taking ownership of this effort; which is highly welcomed and much appreciated.

**DR. IMRAN ALI, PROFESSORS LUMS**

My thanks to Nadeem and the MOC for organizing this event which in my view has been very successful!

Domestic commerce is an enormous sector that by its very range, size and diversity, almost defies analysis. By highlight certain themes, we will be able to understand better, the functions of distribution, wholesaling and retailing, which together represent the domestic commerce sector. One of the obvious characteristics of this sector, but one that the country shares with many other developing economies, is the extreme degree of fragmentation. This factor is closely linked to its other characteristic, that predominantly its activities take place in the 'informal' sector. This is the part of the economy, and once again let us emphasize that it is the predominant part, to which certain other terms are also applied, such as 'unorganized', 'bazaar', 'unregistered' and 'undocumented'. In distribution, some enterprises are in the formal sector, and some of them, such as Allied and United, are of sizeable scope and scale. They are involved in the distribution of products, essentially consumer goods, manufactured by the formal sector, and especially by multinational corporations. Yet a major part of the distribution of formal sector manufactured goods, including that by multinationals, is undertaken within the informal sector. In volume and aggregate terms also this latter segment dwarfs the formal sector wholesaling, distribution and retailing activities. In the vital food industry, and especially in highly perishable products, almost the entire trade is conducted within the informal sector. And it can be preeminently classified as small and medium enterprise. The point is, when we talk of domestic commerce, are we clear what exactly we are referring to? Much of the discussion, and a good part of any suggested interventions, appear to be focused on, and to address the needs of, the miniscule formalized end of these vast operations. The predominant informal sector is seen as an impediment, something to be 'removed' and 'rationalized', a throwback to the past that would 'naturally' disappear in the process of 'development'. This outcome might well take place, but it begs the question whether 'development' will happen. If it is not going to eventuate in the medium or even long term future, then are we putting the cart before the horse? In terms of development not happening even in the long term, this is not indeed so

much an unrealistic scenario as it is an unacceptable intellectual option for planners and ‘modernizers’. If extant structures and processes are likely to continue in the foreseeable future, then there will also continue to be a significant disfunction between the actual situation on the ground and the assumptions and goals of policy makers.

It is in the developed, industrial or post-industrial societies where the informal sector has disappeared, or exists only at the peripheries of economic activity. In these regions major economic, social and institutional transitions accompanied the application of advanced technology to production processes, while sophisticated supply chains and structural transitions in retailing continued to enhance productivity levels. Other attributes of these economies were rising per capita incomes, and the proper implementation of legal and institutional structures to ensure universal property rights. The latter enabled assets to be transformed into capital and hence to be mobilized for investment and further wealth creation. The scale and scope of business organizations continued to grow, leading in many industries to market dominance by large multi-unit, multi-function and even multi-business firms, whose operations were controlled by managerial hierarchies, rather than by the owner-operators more characteristic of family capitalism. These emerging ‘modern business enterprises’, with higher levels of vertical integration and enjoying significant economies of scale, were able to substitute the market mechanism by internal coordination and resource allocation, as well as by more direct relations with suppliers and target markets. The larger raw material purchase requirements, as well as the distribution and sale of the large volumes of marketable products, was undertaken either in-house or through formalized intermediaries. Major consolidation in the retail sector entailed the sale of an increasing, and eventually a predominant, proportion of goods through company owned or franchised outlets, or through independent large-scale retail enterprise.

In Pakistan the production and supply chain, as well as economic and social, conditions for the model outlined above do not yet exist. While ‘visioning’ and ‘projections’ can be comforting exercises, they can also be whimsical and irresponsible. There is absolutely no basis for establishing that these major transitions will occur in the foreseeable future. To restate the case, the extant situation is one where the wholesale, distribution and retail systems are firmly in the informal sector, and they are predominantly small scale

enterprise. This system has deep historical roots, and it also has considerable political importance. Manifestations of such resilience have occurred at vital nodes of Pakistan's past, both before and after 1947. Of course, the transition to more modern commercial structures, and their continued viability and profitability, should be watched with interest, and indeed encouraged, as a harbinger of greater entrepreneurial resources, and reflecting the ability to handle more complex strategic, organizational and managerial challenges. Examining these issues more closely, and deriving from them the right types of policy combinations, could now be the task ahead for both scholars and decision-makers.

**Sohail Jehangir Malik**, HEC Pakistan Professor of Economics University of Sargodha and Chairman Innovative Development Strategies (Pvt.) Ltd

I want to thank the organizers for giving me this opportunity to be a part of the deliberations this morning.

As a Pakistani and an academic economist I want to thank Nadeem Ul Haque for pointing the Ministry of Commerce to the missing area of DOMESTIC COMMERCE in its areas of emphasis. Before this the Ministry of Commerce had been working only as a Ministry of Foreign Trade. And I want to congratulate the Minister Mr Humayun Akhtar Khan for taking up this initiative so quickly and making it a part of his efforts to give Pakistan Trade (both external and domestic) lead growth.

It takes just a cursory look at the structure of our national income to confirm that the domestic commerce sector is more than twice as large as the external trade sector. Moreover, international evidence confirms that the growth multiplier effects of domestic commerce are much larger for economies such as ours. Unleashing the full potential of domestic commerce is the quickest way for Pakistan to achieve rapid economic growth and poverty reduction.

We have already heard from the business community and the policy makers on the issues confronting the development of domestic commerce. As an academic and a researcher I will confine my comments only to the need for solid research conducted on a scientific basis before domestic commerce can play its due role.

There is now almost universal consensus on the role of markets for growth and economic development. While countries like China, Taiwan and Korea have capitalized on the strength of the market to make rapid strides in economic growth and poverty reduction we in Pakistan continue to ignore this potent force paying only lip service to the concept while relying mainly on regulatory means to meet our development objectives.

The general absence of information and the doubtful nature of what is available coupled with a culture that does not generally appreciate the value of good information works against the very basis of what markets are all about. On the other hand the blind reliance on economic regulation coupled with an absence of even the most rudimentary forms of research means that key policy decisions are made in a blind void often at the behest of the powerful lobbies that stand to gain and often with little or no knowledge of the direct or indirect effects of the policies being enforced.

This reliance on regulatory policy making in the absence of even the basic information required for such decision making coupled with the power of the Governments and the lobbies that influence it gives enormous discretionary powers to a few and create the environment for rent seeking behaviour.

The absence of documentation coupled with the lack of access to justice erodes the sanctity of contracts and takes away the ability to enforce these. These are all factors that work against the development of markets in Pakistan. These factors cry out for the need for effective research and analysis.

There is presently no research conducted on a consistent scientific basis on even the basic elements such as the structure conduct and performance of different markets. Even this basic information is missing. We need to have detailed information collected on a scientific basis on the factors affecting the level and development of for example the retail, wholesale, transport and ware housing sub sectors. We also need information on the level of regulation and need or otherwise of tariff and other protection. We need information on the transactions costs both implicit and explicit, and on incentives and disincentives that affect entry to and exit from markets. We need assessments of the governance structure and its implication for the development of strong markets

We need this information disaggregated to levels that best reflect the heterogeneity of these markets. It is only then that we will be able to assess the business environment and devise policy that is enabling.

The Government needs to devise and implement policy to provide a level playing field that opens up the ability of the common man to transact in these markets. The Government needs to become a facilitator in this process to conduct its decision making in an open and transparent manner and reduce its regulatory function to a minimum facilitating level.

I am happy to learn that the Ministry of Commerce has already initiated a set of such studies. Of course this is not an easy task – it will take time. But the information that is collected will start the process.

In today's sessions we have discussed new mandates for policy. We have dwelt on aspects on Technology, Innovation, quality control, new market strategies and specialization. All of these require effective policy research. Moving decision making towards a research base also requires a detailed study. While there is a bright new domestic commerce based future out there it can only come through a solid basis in rigorous research..

## **Conclusion**

Nadeem Ul Haque

This has been an outstanding day of deliberations on a very important subject. Outstanding contributions have been made. Audience participation has been very complimentary of all our efforts.

A moot like this should be judged by its timeliness and the freshness of its discussion. All are agreed that this conference was very important and much needed. It was very well conceived, attended and the discussions were of a high quality.

This conference made 2 important innovations: one it got together several of the key players in domestic commerce and two, it allowed for peer review through a panel of economists to sum up the conference.

I am very grateful to my leaders of domestic commerce for taking the time out to sit through this day long deliberation. It is their sector and their profits that we are attempting to enlarge, and I am glad to see that they have happily taken ownership of the idea.

I am equally grateful to my economist friends for taking sitting through the day to listen and sum up the conference. Such peer review creates confidence in an idea. Unfortunately it is seldom done. With this minor effort, I hope we will start a new trend. Contrary to popular belief, the economists are mostly in agreement suggesting that we do have a good grip on the issues.

All our economists in their summing up have pointed to many problems and difficulties that affect the domestic commerce sector.

- Shortage of land for commercial use
- Law and order problems



- Inadequate legal framework for property rights and speedy land transfers.
- Unfriendly zoning and poor city management
- Lack of mixed use city centers
- Supply chain issues—inadequate transport, no warehousing
- Discriminatory taxation
- Inadequate or misplaced regulation
- Neglect and suspicion or policy

There is unanimous agreement with my initial insight that this

- Sector has been neglected in our history
- We know little about this sector
- We need to immediately begin a serious research effort to learn about this sector
- MOC should take ownership of this sector and review its development
- If we are able to unleash growth in this sector, a much higher sustainable growth will be achieved while poverty will be significantly reduced.

A lot needs to be done and MOC is planning to do it. I congratulate Minister Humayun Akhtar for being very receptive to these new ideas and for championing the agenda.

I accepted Humayun Akhtar's invitation to join him as an advisor because I saw a major window of opportunity in restructuring of the MOC to take fuller charge of its mandate. I am excited by the possibility of my dream being turned into a reality.

I am gratified to hear a unanimous call for research and analysis of this sector. Our critics will hopefully be silenced and we will be able to proceed on to actually getting the work done. I, for one, am looking forward to it.

I look forward to the day our cities learn from Dubai. I long for the day when our cities too will attract millions of tourists offer them all manner of attraction such as huge shopping malls, 7 star hotels, street shopping and cultural, leisure and educational

opportunities to fill a magazine. We will then be truly ready for the many opportunities that globalization offers.

Thank you all for your help and support. Let us all hope for a more commerce friendly Pakistan!