



NATIONAL CONSULTATION PROCESS - PAKISTAN

ENTREPRENEURSHIP IN PAKISTAN

By Nadeem ul Haque

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ABSTRACT

Entrepreneurship is viewed by economists to be a combination of innovation and risk taking. When such activity thrives, high growth rates are achieved as well as opportunities offered to all segments of society, including the poor. The latter benefit from growth and employment, as well as through opportunities for entrepreneurship.

In Pakistan innovation and risk taking is severely inhibited by the intrusive role of government in the marketplace. From the early days of planning when protection and subsidy policies determined winners in the market place, entrepreneurship has been diverted to seeking government favors.

Government economic policy also seeks to promote growth through a basically 'mercantilist' approach where domestic commerce through serious neglect is heavily regulated. This sector either employs most of the poor or offers them entrepreneurial opportunities. Hence deregulating this sector could be a priority in and anti-poor strategy.

The paper also argues that land distribution and city zoning and management have also evolved to further reinforce the prevalent rent seeking path to success. The result is that cities are by design not allowed to become clusters of commerce that will be entrepreneur friendly. These clusters of dense urban commerce are magnets of employment and opportunity for the poor.

To develop an entrepreneurship culture in the country, the system of incentives (laws and policies) that promote rent seeking will have to be dismantled. This paper presents an analysis of the state of entrepreneurship/rent seeking prevailing in Pakistan. This analysis allows us to obtain an understanding of the kinds of reforms (including legislative changes) that are required to develop entrepreneurship.

1. The author acknowledges the assistance of Sofia Ahmed and Khawaja Idrees in the background research for this paper.



Entrepreneurship in Pakistan

1. Introduction

Economic development as a conscious mechanism in countries like Pakistan is a recent post colonial phenomenon. This has been an exciting period in which international agencies and international aid were founded with the objective of achieving economic development and eradicating poverty. The international research networks with fledgling domestic counterparts dedicated themselves to developing policy instruments for delivering this noble objective of plenty everywhere.

Unfortunately, 60 years later poverty persists and many countries like Pakistan are caught in a poverty trap. The international research enterprise has rededicated itself in the last 20 years to understanding the reasons for this policy, aid and donor failure. The answer has come in five different forms.

- a) Economic growth requires institutional prerequisites which underpin human transactions. These prerequisites are those that human civilization has evolved over the years: rule of law, democratic institutions, sound legal framework including an efficient and independent judiciary, modern economic governance including property rights and market developing regulations, and a free and open media. Without these the environment remains very uncertain and full of risk which impairs entrepreneurship and investment.
- b) Economic aid works only where the policy and institutional environment is sound. This again lends support to the 'primacy of institution' argument. A society that achieves the institutional set up described above goes on to achieve economic development. (Landes 1998).
- c) Growth is a result of knowledge accumulation and entrepreneurship (Dejardin (2004&2005). It is innovation and ideas that drive growth and not just infrastructure development and investment promotion that most development policy sought to promote in its early period. In this view growth is all about new ideas and innovation which entrepreneurs take the risk of bringing to the market (Romer 1994) and Grossman and Helpman (1994).
- d) Easterly (2003 and 2005) presents perhaps the most critical view of the international establishment for the development policy. In his view most aid and aid inspired policy as well as centralized and macro approaches to development have all failed to achieve the promise of development. In his view growth happens when policy and management at every level in the economy turns entrepreneurial.
- e) Entrepreneurship need not always be wealth-creating and growth-inducing. Tullock (1989), Krueger (1974) have shown that entrepreneurship can be directed towards the accumulation of wealth through unproductive enterprise. Rents can be earned from government awards of licenses and titles that impede market and goods development. The system of incentives that a country sets up in its governance mechanism can either promote healthy entrepreneurship leading to economic growth and prosperity or rent seeking where productive activities are at a discount. In the latter case, a society gets stuck in a low poverty-low growth trap.²

2. See Murphy Shliefer and Vishny (1993) and Acemoglu (1996)

This paper is focused on the subject of entrepreneurship in Pakistan and how policy and the environment can be adjusted to allow entrepreneurship to play a greater role in the economy of Pakistan. Moreover, it aims to provide a general understanding of entrepreneurship. Following recent research, elements of which have been summarized above, this paper will also argue that economic growth and progress with poverty reduction have both been seriously impeded because of a policy environment which is unfriendly to entrepreneurship.

2. Understanding Entrepreneurship

a. Innovation and Risk Taking

Today entrepreneurship is most commonly viewed as undertaking innovation and bearing risk. Joseph Schumpeter, probably the most important pioneer in the area views innovation as the critical link between entrepreneurship and economic growth (Schumpeter, 1934). He sees economic development as a continuum of a series of new processes, new markets, new sources, and new organizations all of which are products of entrepreneurial activity (Barreto, 1989, p. 28). This innovative and entrepreneurial process allows the 'old' to be washed away by the 'new', through a process of trial and error and a reallocation of labor and capital from the 'old' to the 'new'. There is abundant evidence that the productivity of the new, entering businesses is higher than that of the older businesses that they replace (Haltiwanger 2000).³ Thus indeed, entrepreneurship is something worth pursuing.

Entrepreneurship is rare and unlearned because a) it charts the unknown; and b) experience may be a hindrance to change. Schumpeter's entrepreneur by breaking the established pattern, disrupts the circular flow, and in the process creates excess value, all factors are paid as per their marginal productivity and the entrepreneur reaps the excess. Thus, it is through innovation, that the profit arises and through imitation and competition that it disappears (Barreto, 1989, p.32).

Besides innovation, risk-bearing is an essential element of entrepreneurship. When a new firm, a new product or a new process is formed, prospects are uncertain. It is the entrepreneur who must bear the risks involved since; others lacking the vision may be unwilling to take the risk.

All in all, entrepreneurship is the process of identifying, developing, and bringing a vision to life. The vision may be an innovative idea, an opportunity, or simply a better way to do something. The end result of this process is the creation of a new venture, formed under conditions of risk and considerable uncertainty.⁴ Entrepreneurs are therefore, usually considered to bear risk while pursuing opportunities, and are often associated with creative and innovative ideas. Schumpeter postulated that it is the entrepreneurial actions that cultivate the causes of business cycles and economic development. Hence, providing the entrepreneurs with the right environment is of vital

3. cited in Boumal (1993)

4. The Entrepreneurship Centre at Miami University of Ohio proclaims a similar definition of entrepreneurship.

importance since they play a crucial role in generating change in the market system and even revolutionizing it.

Typically it is noted that entrepreneurs start small and with their own funding. Banks and financiers like to finance success not unknown ventures. Venture capital industry arises in advanced countries to discover entrepreneurs but this industry requires substantial legal and financial development to take root. The institutional infrastructure of poor countries does not lend itself to the development of entrepreneurship.

Box 1 below lists the various definitions of entrepreneurship.

Box.1
ENTREPRENEURSHIP “defined”

- Defining entrepreneurship has remained a topic of immense debate since quite some time now. The definition, 'undertaking innovation and bearing risk', has evolved overtime.
- Mentioned below are some important definitions.
 - ✓ Transformation of demand into supply for profits (Smith 1776)
 - ✓ Creation of organizations (Gartner, 1988),
 - ✓ Carrying out new combinations - later on termed innovation through the process of 'creative destruction'- the old being washed away by the new (Schumpeter, 1934),
 - ✓ Founding private enterprise (Mill 1848)
 - ✓ Exploration of opportunities - being an arbitrageur and an equilibrating agent (Kirzner, 1973),
 - ✓ Bearing uncertainty (Knight 1921), Richard Cantillon (1755)
 - ✓ Bringing together factors of production (Say, 1803),
 - ✓ Ownership (Fredrick Hawley, 1892)
 - ✓ Responsible decision making (Frank Knight,1921)
 - ✓ Exploiting the opportunities that change, in technology, consumer preferences, social norms, etc., creates.

The essence derived from the definitions is that 'innovation and bearing risk' hold the key to entrepreneurship.

Given that innovation and risk bearing is involved, and financing is typically not available, entrepreneurs generally tend to start small; Audretsch and Thurik (2001) note that the observed size of start-up firms is small. A new firm does not know, apriori, what its cost function is, that is, its relative efficiency, but rather discovers this through the process of learning from its actual post-entry performance. Given this uncertainty, the entrepreneurs start, at small scale, even if it is an inefficient one. [(Jovanovic, (1982)]. If the idea is a success, firms become larger through the process of expansion and consolidation, otherwise these die out. Thus the risk inherent in innovation explains why an innovative idea is implemented initially in a smaller firm.

If the innovative idea must be implemented in a smaller set up, and the evidence being that small firms account for only a negligible part of the R&D being actually undertaken (Scherer, 1991) then the question arises from where do the small firms get their innovative ideas? The answer lies in knowledge spillovers. Griliches (1992) suggests that

knowledge spills over from the firm or research institute producing knowledge to another firm that commercializes it. This view is supported by the theoretical models (Romer, 1986, and 1990; Krugman, 1991) that focus upon the role that knowledge spillover plays in generating increasing returns and hence economic growth. The role of geographical proximity has also been recognized in knowledge spillovers. The theory of localization suggests that since geographic proximity is needed to transmit knowledge, especially tacit knowledge, knowledge spillovers tend to be localized within a geographic region [Jaffe, Trajtenberg and Henderson (1993)]. Although the telecom revolution has reduced the cost of transmitting information, knowledge which is based on structures and analysis is not easily acquired and requires specific investment.⁵ It is not surprising that even in today's info-tech world, industries tend to cluster together.

This paper assumes that an entrepreneur is a person who is willing to put his or her career and financial security on the line and take risks in the name of an idea, spending time as well as capital on an uncertain venture.⁶ Entrepreneurship is thus being taken as a process of discovering, evaluating and exploiting opportunities. In a world where ideas drive economies, it is no wonder that innovation and entrepreneurship are often seen as inseparable bedfellows. The governments around the world are starting to realize that in order to sustain progress and improve a country's economy, the people have to be encouraged and trained to think out-of-the-box and be constantly developing innovative products and services.

Hoenig (2005) discusses some essential characteristics of an entrepreneurial economy, the foremost of them being a competitive environment with a level playing field. Such an environment is critical for Schumpeter's creative destruction to materialize. It is the free and flexible markets that will enable the closing down of business that have run their course and be replaced by more efficient firms. It is not hard to see that governmental intervention to protect the inefficient firms will obstruct the process of 'creative destruction', the key to entrepreneurship.

Besides the rule of law, protection of property rights and contract enforcement, Hoenig (2005) considers the availability of a financial system that provides the entrepreneurs with an easy access to capital as a characteristic of a robust entrepreneurial economy. He also stresses upon the need for an educational system that develops the skills of entrepreneurs and workers, and promotes research and development and technology transfers. For example the symbiotic relationship between California's Silicon Valley, Massachusetts' Route 128 corridor and North Carolina's Research Triangle and the California university system are the key to the development of entrepreneurship.

b. Entrepreneurship as Rent Seeking

But sometimes even in the presence of a favourable environment, wealth transfers can be achieved by manipulating economic

5. Entrepreneurial small firms are one such mechanism transmitting the spillover of knowledge. Thus, an increase in the role of entrepreneurship activity may facilitate such knowledge spillovers and therefore subsequent growth (see Audretsch and Thurik (2001)).
6. See Rajan and Zingales (1998) for detail more detail on risk taking in a firm.

environment rather than by genuine business and trade. This section discovers this phenomenon in detail.

When wealth transfers can be achieved through government licenses, policies and directives, entrepreneurial efforts are directed towards gaining such transfers, and economic agents expend efforts toward attempting to influence government actions in their favor in order to accumulate wealth. Examples of such government provided wealth transfers are (1) conferring of a monopoly through a license, (2) obtaining resources at below the market prices (e.g. publicly provided land at cheaper rates than the market to influential groups), (3) protection from competition (e.g., restriction of number of players in a market), and (4) the manipulation of government subsidies, tariffs and tax policies.

In all such cases, the government directive or policy confers wealth on an individual often at the expense of the rest of society. It can be seen as a tax on the rest of society while allowing the proceeds to go to a favored individual or group. The favored groups will then expend real resources and efforts to influence government policy in their favor. These efforts, among others, include lobbying and bribery. Note that not only is the wealth transfer unproductive, it often distorts other market activities as well. In addition it leads to the diversion of real resources, which might have gone into productive efforts, into unproductive activities, termed rent seeking.

Thus entrepreneurship, though extremely essential to growth, may at times turn into rent seeking. Since profit motive is the key driver of entrepreneurship, if more profits are to be had from rent seeking, then the agent would rather be a rent-seeker than an entrepreneur. This phenomenon was concisely put by the notorious thief Robert Sutton who when asked why he robbed banks, answered: "Because that's where the money is."⁷ Box 2 briefly describes "rent-seeking":

Box. 2

RENT SEEKING

- Rent seeking is defined as a situation in which an individual or firm makes money by manipulating the economic environment rather than by profit making through trade and production of wealth.
- In other words rent seeking is manifested when the bottom line of its social consequences is negative. It results in the sub optimal allocation of resources and its moral hazard can be considerable.
- The social and economic effects of rent seeking take many forms. In the long term, the result is the distortion of the structure of social and economic incentives and misallocation of resources, leading to heavy welfare losses and social cost.
- Rent seeking hinders economic growth and social development. Most of the population in the developing countries has no opportunity to engage in rent seeking, as they do not have the necessary resources. The only part of society which will be able to assert its claims are those with the corresponding capacity and channels of influence for rent seeking - generally the upper class and the bureaucratic middle management (government service officials and clerks).
- Rent seeking can also be described as corruption, where politicians and bureaucrats specifically exploit their opportunities to manipulate the existing institutional framework so that in future it serves their own private interests.
- Examples of rent seeking are: corruption, stealing, bribery, at times formation of cartels, seeking abusive judicial compensation or protection seeking with the purpose of limiting economic competition and promoting particular interest.
- Rent seeking can originate from both the public and the private sectors, and persists widely in Pakistan.

Sources: <http://en.wikipedia.org/wiki/Rent-seeking>
 Erra Dabla Norris (WP/05/43)
<http://www.edcnews.se/Research/RentSeeking.html>

7. Cited in Boumal (1993).

As mentioned earlier, at times rent-seeking might be preferred over entrepreneurship (Baumol, 1993). During the reign of the Plantagenet's and early Tudors in UK, the king was the primary source of income, privilege and landed property. Hence economic activity by leading subjects of the crown was directed towards that end. However during the reign of the Stuarts, when the Parliament circumscribed the rent-granting powers of the Monarch, economic activities were redirected towards commerce and trade, thereby providing an explanation of subsequent success of British economy in the 19th century.

The foregoing explains that entrepreneurs may be tempted to turn to rent seeking if the payoffs so warrant. Therefore, it is important to avoid policy intervention that ends up in providing rent-seeking opportunities to the favored few and foreclose the rent-seeking opportunities that Britain can be attributed to the institutionalization of the rule of law, well defined property rights, protection from arbitrary confiscation of property, effective enforcement of contracts and a variety of other protections that made rent seeking difficult. On the other hand the poor record of technological progress in ancient Rome, Medieval China and more recently in the Soviet Union, despite the many impressive inventions that each one was able to generate, is attributable in good part to ready availability of rent-seeking opportunities. This, together with obstacles to entrepreneurship in those economies, accounts for the failure to put the inventions to productive use.

3. The Nature of the Pakistani State

Carved out of pre-partition India in 1947, the new state of Pakistan found itself with few state assets, an entrenched local feudal aristocracy, and a largely migrant professional class of civil and military officers and entrepreneurs born out of retreating colonial bureaucratic and military structures. As time went on the military-bureaucratic complex saw itself as the savior of the country in many different roles: those who had sacrificed for the new state; the visionary nationalists; the modernizers; and the 'deliverers of development'.⁸

Following the trends of the day Pakistan too like India, put in place a planned, closed economy for a big push towards an industrial take off. Central planning thus assumed the 'government knows best' approach and developed a deep suspicion of the market. The result was a plethora of legislation for a fully government directed economy. The state increasingly moved into developmental functions - developing infrastructure, providing services, and managing and curbing markets. This expansion of the state was fuelled by the growing donor community. The availability of easy financing, as well as expanding control over state resources, provided bureaucrats with incentives to consolidate the system of directed development.

Gradually, the governing bureaucratic elite, in charge of all the country's resources and the development agenda, realized that while direct salary structures needed to be compressed in response to

8. The Pakistani state has been characterized as 'overdeveloped' (Ali Cheema) (2006), 'military-bureaucratic complex' (Alvi (1986)), 'authoritarian' (Jalal (1995)), 'elitist' (Hussain (1999)), and 'bureaucratic' (Niaz (2007)).

egalitarian rhetoric, rent seeking activities could more than compensate them for their unrealistically low salaries. State owned enterprises, state-led land development, licenses and controls, and development projects, were all lucrative devices for rent seeking.⁹ Given the resource constraint, both physical and human, the quality of governance began to decline; which in turn reinforced rent seeking and gradually led to involvement of the government functionaries in direct corruption with enrichment as their objective.

Rather than entrepreneurship, policy planned for investors and investments became the norm. Incentives were offered to attract investment which included licensed monopolies in protected markets, cheap land and credit, and subsidized inputs.

Deep capital controls were adopted along with foreign travel restrictions ostensibly to conserve foreign exchange. The closed economy as well as the well-meaning dictates of planning saw financial repression as an easy means of taxation. In the final analysis, even the banking system was nationalized in 1972 so that it could be a full partner in the planning effort. The beneficiary of the cheap credit was the influential protected investor and the government, both of whom found it easy to default. For political reasons, default was not considered a serious crime, thus increasing the subsidy element to investors.

Since the path to success lay with the state, and the state used the metric of granting favors to confer success, entrepreneurs began to invest in developing rent seeking networks with key government officials at the center. This is now the dominant regime of business operation in the country. This did not allow for the development of entrepreneurship in the sense that modern economics and business has come to know - an innovator, a risk-taker, and a builder (Schumpeter (1950), Knight (1921), and Drucker (1970)).

Instead, the incentive regime created a rent-seeking businessman used to gaming and (mis)using policy. These new classes of businessmen, who acquired wealth and learnt ways to manipulate policy, became dominant. As a result, wealth remained concentrated in the hands of those that the government favored. Consequently, even in private enterprise, merit gave way to government discretion. This environment slowed the growth of entrepreneurship and indigenous enterprise.

Keeping the economic definition of entrepreneurship in mind, we see that entrepreneurship in Pakistan is seriously impaired by government policy, legislation and regulation. The government has continuously been of the opinion that investment, especially at the large industrial level, is entrepreneurship. As a result, it has been unable to promote genuine entrepreneurship, and promoted cartelization and rent seeking instead.

9. Alvi (1986) has characterized the state as "that excessive enlargement of powers of control and regulation that the state acquires, extend far beyond the logic of what is necessary in the interest of orderly functioning of the peripheral capitalist economies over which the state presides, and specific needs of each of the dominant classes."

4. How did Entrepreneurship Develop in Pakistan?¹⁰

In Pakistan, policy has always been biased towards the elite. This is especially true of the economic policy which has been biased towards the large scale sector.¹¹ The result is that this sector has developed on the incentives of rent-seeking rather than entrepreneurship. The development of small scale sector to some extent reflects the characteristics of entrepreneurship; however this sector has largely grown up as an informal sector continually besieged by the state in its quest to protect its favorite child - the large formal sector. Below we will attempt to understand the historical tension between rent-seeking and entrepreneurship in Pakistan.

a. The Big Push for Industry

For most of the time since independence, 'enterprise' for the government was synonymous with large industry only. Various policy measures, such as tariff protection, import licensing schemes and other controls on imports, rather than enhancing productivity or encourage industrialization for growth, adversely affected the country by giving rise to a new elite - not entrepreneurs but rent seekers. The government policy was never neutral and favored industrialization throughout.^{12,13}

The period, 1947-1958, was that of emerging exchange rate and trade policies and industrialization for import substitution. Although in its first five years after independence the country achieved impressive growth rates despite the non-existent base and the odds that existed. From 1953 to 1964, virtually all imports into Pakistan were regulated by some form of quantitative controls. With controls imposed on imports, especially on consumer goods, the prices of such commodities rose sharply in the domestic market causing a change in the terms of trade in favor of industry and against agriculture, resulting in a sharp increase in the productivity of the industrial sector. As a result industry became a lucrative sector and traders converted their merchant capital into industrial capital, thus triggering the process of industrialization in Pakistan. The large scale sector experienced phenomenal growth rates of over 20% from 1950 to 1955. Thus right from the initial years, the government of Pakistan adopted the policy of favoring tariff protection as a way to promote industrialization, with special emphasis on large scale sector. Besides, the beneficiaries of the licenses were often the big business houses - the favored few (White, 1974).

It was in the '50s that the "Import Licensing System" was introduced and was functioning actively. The system basically affected the decisions of the investors regarding what to import, and hence

10. For this section we make liberal use of Zaidi (2005).

11. See Haque (2006) and Husain (1999).

12. Lewis, Stephen, op.cit., 1969

13. Ishrat Husain sums up the current position with industry thus: "Large scale entrepreneurs in Pakistan have been protected from market forces of competition and have been provided ample rent seeking opportunities by government policies. The import substitution strategy that provided a highly protected environment for domestic manufacturing industry in consumer goods and textiles insulated the industry from market tests of efficiency and competition----The external competition which would have beneficial effect on the diffusion of technology and innovation, efficient use of resources, and managerial and organizational skills, was conspicuously absent and left Pakistan's industry lagging behind its competitors." [Hussain, (1999, pp.344-45)]

suggested what kind of industrial development should take place? It affected the structure of imports and the set of domestic relative prices and was used as a protective or “exchange saving device”.¹⁴ The licensing system and the exchange rate policies were such that almost all of capital goods and non agricultural industrial goods were being imported. Therefore the state played a central role in defining the structure and the nature of industry in Pakistan through its protection methods. As an example, Box 3 describes how concentration on the textile industry has adversely influenced its performance.

Box. 3

TEXTILE INDUSTRY

The development of textile industry offers an interesting example of rent seeking. In 1959, the 9 largest industrial houses accounted for 50 percent of the total production, with five of the biggest contributing as much as 37.3 percent. The Saigol group alone controlled 15 percent of total production of cotton textiles in West Pakistan. Thus, initially, textile industry was totally located in large scale manufacturing sector and was highly concentrated amongst a few industrial houses and it was these industrial houses that made fortunes out of textile business largely because of the favorable treatment accorded to the sector by the state.

Between 1960 and 1970 Pakistan's textile industry enjoyed over 11 percent of the world market share but today the corresponding figure is only slightly over 2 percent. By contrast, in 1972 Hong Kong and Korea held less than Pakistan's share while in 1988 the share of the two countries had risen to 9.0 and 6.5 percent respectively (Zaidi, pp. 139-40). Furthermore while Hong Kong and Korea shifted to higher value-added sectors, Pakistani textile sector remains fairly concentrated in low value-added products.

Pakistan was unable to even fully utilize its quotas. The two countries were able to beat the quota regime by diversifying into higher value-added sectors. In the nineties and the early 2000s textile manufacturers were making large profits by merely trading quotas rather than diversifying into higher value-added products where quotas were not required.

In the perspective of globalization and WTO, the textile industry, despite receiving protection under high tariffs, with subsidies, concessionary finance, subsidized cotton prices and numerous other incentives, has not been able to achieve high efficiency.

Moving on, the period between 1958 to 1968 is popularly known as the “decade of development”. The economy, especially industry experienced a relatively higher growth rate during the Ayub Regime. A critical examination reveals that between 1958 to 1970, 65% of total loans disbursed by PICIC, a public sector financial institution, went to 37 monopoly houses, with the largest 13 of these accounting for about 70% of the loans. This serves to prove that policy framework during the 50s and the 60s was highly biased in the favor of big business houses. They were not only able to obtain cheap credit and foreign exchange from the banks that they owned, but could also mould state policies in their favor through their contacts in the bureaucracy. As a result, these business families were able to influence exchange rate, import, credit, fiscal and other policies.

14. Lewis, Stephen, op cit 1969 and 1970.

The decade of development was followed by the Bhutto years from 1972 to 1977. His regime was characterized by the nationalization of the large scale manufacturing sector, insurance companies and banks, causing a dent in the concentration of economic and political power that only a few families were enjoying. Still however, since the nationalization times, banks have continued to lend to borrowers on the basis of political and governmental influence and contacts. These then, were obviously the people who were well connected with the prevailing governments and were able to obtain loans easily and leading to the encouragement of this elite rent seeking class. This resulted in losses on bad loans for banks to the extent that, for example, governments had to inject equity of RS.20 billion and RS.7 billion into United Bank Limited (UBL) and Habib Bank limited (HBL) respectively to make these viable for privatization that took place in the recent past.

The Zia years from 1977 to 1988, was a period of denationalization and encouragement of the private sector. Unfortunately, again importance was given to the large scale manufacturing sector and a number of heavy industries were opened up which were given numerous incentives including tax holidays! Therefore, in the 1980s, small scale manufacturing sector developed in the context of a difficult industrialization process; where import substitution strategies led to an unbalanced sectoral composition and caused further bias as mentioned earlier in favor of large scale capital intensive production methods.

b. The Neglect of the 'Small'

The historical evidence clearly indicates that, in the context of Pakistan, when one talks about industrialization, for most people it implies large plants and factories run by machines and employing a large number of workers. It definitely comes as a surprise to people when they discover the reality; that it is actually the informal sector and the small scale sector that dominates our lives,¹⁵ both of which have been continuously ignored in our economic policies.

Today almost 40% of business takes place in the informal sector, and still as compared to the large scale industry, the small scale enterprise and industry continues to face unfavorable policies. Neglect of the sector on part of the government is evident from the fact that even today actual growth rate of the sector is not computed in the way it is done for large scale sector), and instead it is merely imputed. The small scale and the informal sector may be much more dynamic and productive than what government figures have continued to show till today. It is also important to note that the small scale sector is the breeding ground for innovation but continues to attract little research.

Historical growth rate of small scale sector, also point towards the neglect of the sector. From 1950 to 1962, the small scale manufacturing sector showed a consistent trend of only 2.35% growth, followed by a stagnant figure of 2.95% growth rate over the next 8 years! Similarly, from 1977 until recently, again a consistent trend of 8.4% growth rate has been noted. From the 1990s, this trend

15. Akbar Zaidi, (2005)

further fell to another stagnant 5.3% growth rate. Despite the fact that informal sector is labor intensive, the sector has not received the attention that it deserves. Labour intensive nature of the sector is evident from the fact that though the share of the urban informal sector rose by 3.6 percentage points between 1972 and 1986 the employment in the sector showed an annual increase of 4.3 percent during the corresponding period. Generally, the informal sector and the small scale sector in Pakistan has dominated employment in the construction, wholesale, retail trading, hotels, transport, communications and storage industries in urban areas.

Interestingly, if we consider the institutional framework within which our industry has been developing, one or the other government institutions established solely for the facilitation of the small scale industry and enterprise have always been there. For example the National Small Industries Development Corporation, the Small Scale Industry Corporation and SMEDA have existed since long, but the actual growth of the small sector shows that these institution have done little to facilitate the sector.

The ignorance subjected towards this sector can be also gauged from the fact that data available on this sector is extremely inadequate and in unsatisfactory condition, further creating problems for policy making, since it too requires statistical evidence again reinforcing the fact that the state has remained extremely indifferent to this very valuable sector.

c. Agriculture and the Elite Bias

Agricultural growth was impressive in each of the green revolution years between 1960 and 1970. The main elements of the green revolution were: tube wells, tractorization and high yield varieties (HYV). All these three elements have been a source of rent seeking. First, inducement to invest in tube wells was given to farmers through large public subsidies on fuel, installation and maintenance costs. Besides this, the Agricultural Development Bank followed a liberal credit policy and made numerous loans to farmers so that they could set up private tube wells. Similarly, according to Akmal Hussain¹⁶ the purchase and use of tractors were encouraged through the cheap availability of credit. On top of this the overvalued exchange rate made tractors available in Pakistan at below world market prices. Finally, high yield varieties (HYV) of food grains were provided to farmers at subsidized prices. Its noteworthy here that HYV required plenty of water and therefore mainly the farmers owning tube wells were able to benefit from HYV.

Given the indivisible and large capacity of diesel and electric tube wells even the middle level peasants were not able to afford their fixed and variable costs (Hassan).¹⁷ Thus seventy percent of the tube wells were put in by farmers owning 25 acres or more. Similarly, tractors were not feasible for small farmers and the benefits of HYV required plenty of water therefore its benefit was available only to the large farmer. Summing up, it can be noticed that the beneficial effect of the

¹⁶ & ¹⁷ in Zaidi (2005, p.30)

green revolution, that has been a case of incentives from the government, remained restricted to rich farmers only. In words of Akmal Hussain, "The new technology made it possible to accelerate agricultural growth substantially through an elite-farmer strategy" which concentrated on the new inputs on large farms only.

d. Subsidies for Export

While the rhetoric has always been the growth of exports, policy has never quite embraced openness. For the promotion of exports large government machinery is maintained while there are several subsidy schemes that have been tried over the years.

Currently, there is an export refinance scheme which allows exporters' access to concessionary finance, a duty drawback scheme which refunds duties charged on inputs used on exportables and a freight subsidy. Haque and Kemal (2007) have shown that these subsidy schemes have not worked as intended and quite often may not even have been used as intended.

Surprisingly, the exchange rate has not always been supportive of exports. In the sixties, there was a dual exchange rate system that was used to subsidize machinery imports and penalize consumer imports while offering a large subsidy to exporters. This policy again favored large scale industrialist and exporters at the expense of small scale domestic producers and traders.

Although the exchange rate was unified in 1973, the policy has been to resist the rupee from finding its own market determined level. Through most of the last 2 decades, the rate has bordered on overvaluation. Interestingly, this policy runs counter to the mercantilist policy stance, that is maintained otherwise, quite possibly because of the need to protect the engineering lobby that has now developed through our protectionist policies.

The picture of Pakistan economy that emanates from the foregoing account is that of a planned economy that emphasized growth through industrial development for import substitution and export promotion. The businesses have grown on the back of various protective measure that had a tilt towards rent-seeking rather than welfare improvement. The variety of protections available to businessmen had reduced their risk to almost zero. The incumbents risk in carrying on traditional activities being nil or in other words the profit from rent seeking being higher, they were not inclined to innovate. In such an environment even the potential entrants are likely to eye rents, rather than innovate and indulge in risk-taking. Thus incumbent as well as potential businessmen carried found no incentive to engage in entrepreneurship - innovation and risk-bearing. As a result, the planned, big-push led to some unintended consequences, the next section is devoted to these consequences.

5. The Unintended Consequences

a. Inequality and Bank Defaults

The pattern of development pursued, in '50s and '60s led to high degree of concentration. Papanek shows that in 1950 there were 3000 individual firms but the concentration was so high that only seven, individual, families or foreign corporations constituted 25 percent of all industrial assets in united Pakistan and only 24 units constituted nearly 50 percent of all industrial assets. During later years of Ayub's regime, Dr. Mahbub ul Haq claimed that 22 families controlled 66 percent of the industrial assets 70 percent of the insurance and 80 percent of banking assets. Similarly seven of the seventeen Pakistani banks were under the direct control of monopoly houses accounting for 60 percent of total deposits and 50 percent of loans and advances. Besides Public sector financial institutions like PICIC and PIFCO were structured to provide loans only to larger and more established firms that had adequate security and high profit rates (Zaidi, 2005, p.96). This pattern of development had incentivized the big monopoly houses in rent seeking. Some case of rent seeking, attributable, directly or indirectly to big business houses of the '60s have been documented by Lawrence White (1973), are listed in Box 4.

Box. 4
LARGE FAMILIES AND RENT SEEKING DURING '60s IN PAKISTAN

Lawrence White (1974) records some of the instances of rent-seeking, during '60s, arising due to the influence of the then large monopoly Houses:

- Companies and groups controlled by 43 large families received capital goods licenses worth RS. 1512 Million or 50.9 percent of the total licenses issued between 1960-1965
- White (1974) estimates that statistically strong and significant relationship existed between family importance in 1968 and the receipt of foreign exchange licenses in capital goods between 1960-65.
- The distribution of licenses in '60s seems unrelated either to the reported profitability of the family-controlled firms at the beginning of the licensing period or to the resultant profitability that accrued from licenses.
- Lewis and Guisinger¹⁸ found that a number of industries were given explicit and implicit subsidies; in the absence of this protection they would have generated negative value-added and would have ceased to exist.
- White (1974) goes on to the extent of suggesting, that unless one was willing to value all the inputs into the industry at zero opportunity cost, the real welfare gains would have been higher had the industrial growth been slower.
- Extra subsidy was available to cotton textile, over and above, what was available to Jute textile, a product of the then East Pakistan.
- Jute exporters were given bonus vouchers¹⁹ that were good, only for importing, jute textile machinery while cotton textile exporters were given regular vouchers that were good for importing anything and were therefore more worthy.

18. Cited in White (1974)

19. Bonus vouchers were used to compensate exporters for an over valued exchange rate and were tradable on stock exchange.

Public sector financial institutions have faced huge loan defaults during the '90s. Ishrat Hussain (1999) notes that these institutions were used to accord political patronage to reward loyal followers and to win over adversaries. The cost of the project was almost always shown to be greater than the actual cost so that the loan for the project (60-70 percent of the total project cost) would be enough to finance the equity portion of the project as well. Such loans were often not repaid which in essence meant that the project has been gifted by the bank/government at the expense of the banks' customers. Later the bill for the default was picked up by the tax payer. As a result the banks became so weak that the government had to create a separate corporation to which the non-performing loans of the banks were transferred so as to make the banks viable for privatization.

b. Crippled Innovation

Another consequence and impediment to the growth of entrepreneurship in Pakistan is that innovation has been severely limited as the planning apparatus²⁰ has been unable to understand it. The planning model developed in the country since independence, encourages government interventions on the assumption that markets fail. But recent privatization stories are evidence of the fact that governments can fail as well. Innovation on the other hand, requires entrepreneurs to be able to take risks fearlessly. As such innovation is only possible in the private sector. The nationalization period in Pakistan affected it quite adversely and in the years to come very little of it could take place, since the private sector was again adjusting itself after the policy was abandoned in the Zia regime. As a result the entire essence and the spirit of innovation were strangled.

The public sector was unable to bring about innovative changes mainly due to the risk averse nature of the jobs in it. It has to be realized that innovation and the usage of technology accompanied with a well trained labour force helps foster a competitive business environment. The 'Enterprise Surveys' carried out by the World Bank²¹ suggested that only 17.01% of the 965 firms surveyed have ISO certification ownership. Out of the sales of these firms only a depressing 0.57% is spent on research and development. Currently, according to the Global Competitiveness Report 2004-05, Pakistan's innovation index is 91/125, indicating how despite the government industrialization promotion efforts throughout, Pakistan still falls in the lowest band in the field of innovation when compared with a sample of 125 other countries.

c. Rent Seeking and Land Development

Land development and allotment in Pakistan has been a rent seeking opportunity involving all those in power including civil servants, judiciary and the army. This may have become the single most important impediment to development. How did this happen?

The British colonial administration had already instituted a system of land grants to reward loyalty and service to the state. This form of rent seeking was further reinforced in the new state. The mass migration in the subcontinent at partition brought in a large number of professionals who made up the administration and the army. Early on

20. For details of the "planning model" pursued in Pakistan see Haque (2006)

21. the most recent surveys were conducted in 2002

they established a principle of compensation for migration based on land grants from the state.

The new state in its development mandate also had to accept the demand for greater equality and broader access to the government largesse. This translated into a tax system that increasingly became more progressive, an increase in government employment and a pressure for more equal salaries within government. Those with power over the exchequer naturally reacted by gaming the system to retain low visible taxable salaries while increasing their compensation in terms of perks and controls that could be used for rents.

One major wealth accumulation strategy that has gained ground over the years is the state provision of subsidized land to those with power. Even in colonial times, the government gave cheap land in newly irrigated and developed areas to the loyal servants of the state. The government which was taking the lead in development in the newly developed state continued with this policy and soon the bureaucrats and the army were into this in a big way. The process evolved to the point where more and more urban land was developed to satisfy this demand. The process evolved through the development of Islamabad and later the Defense Housing Authority schemes.

Over time other segments of society with some access to government machinery began to claim their share. The process being used, which has evolved over time is based on an old law for the development of rural societies through cooperatives. Employees of public sector agencies (utilities, universities, hospitals etc) which do not have access to subsidies through the prime developments such as Islamabad and Defense form a cooperative and to the extent that they have the political muscle can use the Land Acquisition Act to develop a housing scheme in peri-urban areas. This can lock in large gains for those who have been entrepreneurial enough to see the cooperatives develop.

The profits from the land-game being higher than from productive business activity, interest as well as money shifted from business to trading in land leading to dramatic rise in real estate prices. Thus the land-game adversely influenced entrepreneurship (i) by increasing the cost of doing business as acquiring business premises became costlier; (ii) shifting the interest of businessmen away from entrepreneurial activities; and (iii) by locking in funds that could have been available for entrepreneurial activity.

d. Non-commercial Cities

This rent seeking through cooperatives and the use of the Land Acquisition Act has distorted the urban land market as well as the development of cities. Cities through history have been the refuge of the poor, places of opportunity for social mobility, a hatchery for entrepreneurs. History and civilization moves in cities. All major scientific, social, political, economic and technological innovations have happened in human agglomerations known as cities. Great civilizations and empires have been developed around cities. It is no accident that the dominant empire of any time has the most important, creative and fascinating city of the time.

The best cities have been places of learning and idea development. Cities such as London, Edinburgh, Paris, Los Angeles and New York

have been a birthplace of invention and creativity. Measured productivity increases in large well-organized and creative cities as seen in the figure above; GDP per square kilometer is highest in the most commercial cities of the USA.

The bulk of the output in any country is produced in the cities and it is noted that the difference between poor and rich countries often lies in the productivity of their cities. In the post-industrial information age, creativity creates value. Creative cities enhance individual productivity and are multi-ethnic, open to immigration, culturally rich, dense, full of learning and innovation, allow for eccentricity, and offering many and diverse learning experiences.

It is important for entrepreneurship to establish in cities because cities allow space for everyone and all activities. All classes live in cities. Often the poor and middle class live in cities while the rich estates move to open suburban environments. Cities offer community and networking infrastructure - libraries, community centers, sporting and conference facilities and theatres - to all, especially the poor and the middle classes.

The young, the poor and the middle classes along with their creative activities live with businesses in busy 24-hour downtowns. These city centers are the heart of a city and define a city. All development around a city is then relative to this city centre. City centers are a magnet for ideas and migration. In fact globalization is really the network of ideas generated in city centers.

In Pakistan, cities have been unable to perform these functions for several reasons:

- Urban authorities because of this preoccupation with elite housing have discouraged downtown development. Commercial development and city center development is discouraged while elite housing schemes based on the cooperative model are encouraged.
- Urban zoning remains very unfriendly to urban density, high rise buildings, mixed use development, and commercial uses such as hospitality, retail and warehousing. With the result that there is a huge excess demand for office, retail, apartment, warehouse, storage as well as education and community space. All these activities currently take place in the single family house that the city planners encourage.
- Commercial development especially large scale which will be employment generating is punitively taxed almost as if it were a sin. To begin with the definition of commercial is anything but a single family house. Hence a low income block of flats is also considered to be commercial. To build anything commercial, permission has to be sought which in itself may take years and may involve the army top brass in certain localities. The fee alone for approval after many years of lobbying ranges from 50-200 % of land value. It is no wonder that all construction remains small in Pakistan and that no tower cranes are visible anywhere.
- The fact that people want to convert residential plots into commercial plots implies that there is excess demand for commercial space and that the zoning authorities have not

provided for commercial space at the planning stage. The failure to plan adequately has to be paid for by the people as high commercialization fees are charged and cumbersome procedure is involved. Thus zoning remains inimical to entrepreneurial activity.

Zoning and Land Allocation rules and regulations and property right acts can play a vital role in the encouragement of entrepreneurship. Adherence to such laws ensures that a country's land and other property are used for the common good. Numerous national and provincial acts and ordinances regarding such issues exist since quiet some time now.²² Had they been strictly implemented, business men would not have been facing problems regarding land allotment, commercialization of land and protection of their properties. A critical evaluation of salient features of the commercialization policy practiced by the Punjab government is included in Box 5.

Box. 5
COMMERCIALIZATION OF PROPERTY (Haque and Anwar 2007)

- Commercialization is defined to be any building other than a single family home of 2 stories. Building with flats is considered as commercial development.
- Commercializing one's property in Pakistan is a daunting task indeed. One not only has to go through a lengthy process but also incur numerous costs.
- Currently, commercialization fee is claimed to be 20% of the value of the urban land. Interestingly, the cantonment areas have a much higher commercialization fee even up to 50% of the land in some areas. In practice the fee is much higher. Commercialization of one *marla* of land on Bank Road, Rawalpindi, one will have to pay in excess of 1 million Rs. as commercialization charges (1 million Pak Rs. are equal to US \$16,667 approximately); by contrast rezoning cost in Salisbury, North Carolina, USA, is US \$500 (Pak Rs. 30,000). This high fee also acts as a disincentive for owners of the property to commercialize it, explaining why there is a shortage of the supply of commercial property in the first place. And if one is able to commercialize his property to set up a business, the cost of doing business rises.
- Zoning laws allow buildings up to 38 feet high and penalize building beyond that. Any building above 38 feet is charged at Rs. 60 per sq. ft of covered area above 38 ft. height. The ceiling on the height of the building further aggravates the already existing problem of shortage of land for commercialization.
- Conversion of property to commercial use also often requires the permission of neighbors and possibly and additional payoff.
- Another disincentive for potential businessmen is that, when it comes to electricity, gas, water tariff, and other taxes the commercial property in Pakistan is again subject to higher rates than residential property.

22. The following is a list of a few existing land related regulations:
 1. Defence Housing Authority Lahore Ordinance (1999)
 2. Commercial Policy of Punjab (1999)
 3. The Punjab Local Government (Commercialization) rules, 2004
 4. Capital Development Authority Ordinance, 1960
 5. Cantonments Ordinance, 2002
 6. Cantonments Act, 1924

- The city center land in most major cities is owned by the government for office, housing and leisure (polo, golf and tennis) space for the elite members of government. If we measure the difference between the potential of this land for city development, employment generation and entrepreneurship and its current use, it would give us a tax that is imposed on the citizens of the city. This tax in most cities would be very large.²³ With city center land so controlled, downtown development is seriously impeded and driven into informal channels.
- Real Estate development and construction as a business remains a fledgling industry. Industrial protection policy continues to discourage the import of construction equipment such as tower cranes, cement mixing trucks and truck mounted cranes. In most countries these businesses are large opportunities for employment and entrepreneurship. In Pakistan this is not so.

To sum up the zoning laws and commercialization policies rather than providing a favourable environment for entrepreneurship have in fact impeded entrepreneurship.

6. Understanding Business in Pakistan

With this background, PIDE held a series of Focus Group Discussions with businessmen of Lahore, Sargodha, Sialkot and Gujranwala to elicit their views regarding the state of entrepreneurship in Pakistan. The following discussion is based on the common themes that emerged in the focus group discussions.

Our discussions revealed two interesting themes;

- Innovation which is the key to entrepreneurship seems to be nearly absent. Most of the businessmen seem to be involved in inherited business. The few entrepreneurs that we met had stumbled upon their business, did so as a result of some information advantage. Either they were employed in that business or involved in trading in it or some acquaintance provided some information. This is in keeping with entrepreneurship stories in other countries.
- Most of the businesses were 'imitation.' Investment fashions appear to dictate entrepreneurship. Investors seem to rush into areas that are in vogue. For example, textile wave was followed by the garment factory wave, the socks wave and so on. In the past the waves happened because of government policy incentives. Now we need to understand why this trend remains dominant.
- Business is not dynamic; few businesses seem to grow to be large conglomerates and multinationals. Small businesses seldom seem to even develop across cities leave alone grow into international conglomerates. Why? For business and market growth, innovative entrepreneurship and dynamic markets which allow businesses to grow are a prerequisite. It is in such an environment that employment grows and opportunity expands.

23. On most of these properties the government does not pay the city any property tax. Alternative real estate development in this downtown property could enhance tax revenues substantially. This allows us to estimate the tax that the government collects from the city by maintaining these claims on city properties.

Such an environment is also the most poor friendly and conducive to social mobility. Hence we focused on these areas in our discussions in 4 major business cities of Pakistan. Our respondents identified the following factors that were responsible for the poor business environment.

a. The Attraction of Rents

In all the focus group discussion the businessman, by and large, expected of the government to provide incentive of one or another kind that would either place their business in a favorable position vis-a-vis other businesses or that would protect their business that has run its course. For example businessman in smaller towns of Sargodha and Gujranwala demanded government protection against Chinese goods. Besides, the businessman in Sargodha also wanted some relief on account customers lost to Lahore with the construction of Motorway. Given the Schumpeterian process of 'creative destruction' the businesses that have lost their customers to another city/country, due to being less efficient, should be close down and in their place new businesses should have emerged.

Given the rent-seeking culture that has now been established, businessmen, rather than focusing upon innovation expect that the will government help. For example, most were always seeking a tariff or a subsidy advantage. Consequently, they were not comfortable with free trade in all products. Another example was the demand for cheap credit regardless of the cost to the tax payer. However, when pushed they admitted that credit constraint was not major factor constraining their growth. There was also a serious lack of knowledge of other financial instruments and an excessive focus on bank financing.

b. The Costs of Corruption

Corruption is a serious impediment to the growth of entrepreneurship. The businessmen involved in manufacturing of various products, told that numerous government departments (numbering around 15-20) 'visit' enterprises with various threats to extort small sums. They collect anywhere from 0.2% of annual sales to about 5%. Obviously the tax incidence is higher on smaller firms. Businesses dedicate from 1 to 3 employees for dealing with this extortion.²⁴ Their view was that if there could be a single tax that could be collected by Central Board of Revenue (CBR) and distributed to these people transaction costs could be significantly reduced.²⁵

c. Lack of Research, Expertise Skills and Knowledge

Business in Pakistan remains largely owner-operated and resistant to developing professional management. Partly this is because business growth has traditionally depended on policy favors rather than on professional management and strategy. However, there is

24. It takes 2-3 years from the day the project is conceived to the time operating activities are actually commenced. The reason for the long lags involved is bureaucratic procedure. Bank financing also can take a long time.

25. In the context of taxation a form of rent-seeking being resorted to by the tax officials is the threat of detailed audit. Under the self assessment scheme for filing tax returns a certain percentage of returns filed can be selected for detailed audit. Out of the returns filed which one are to be selected for detailed audit, the discretion in this context rest with the tax officials. The enterprises are threatened with detailed audit to extract bribe money.

also a clear mistrust of professional managers given that the legal and judicial systems may not prevent fraud, theft and outright misuse of business information.

During the discussions we felt that, businessmen however, are beginning to understand the demands of globalized business growth. They admitted that an important reason for slow growth as well as developing new business was the lack of expertise and knowledge. In all cities, there is no expertise for providing advice on key areas such as assisting project feasibility, operating a business, establishing brand names, and marketing.²⁶

Almost all the businessmen complained of the scarcity of skilled labour. Hoenig (2005) emphasizes an educational system that develops the skills of entrepreneurs as well as that of the workers to foster entrepreneurial economy. While various management schools have emerged, technical and skill-based professional education remains in short supply. Trade bodies and chambers asking the government to make an investment in this area and not incurring the cost themselves once again remind us of the rent-seeking paradigm. Interestingly, technical skills are not adequately rewarded by the employers; nor are blue-collar jobs held in esteem by society.

Another reason why imitation occurs in business development is the lack of information on potential projects. As we have seen before, innovation is undertaken by the smaller firms (Audritsch, 2001), these smaller firms get their innovative ideas by way of knowledge spillovers. Given the lack of, market depth, research institutions and universities and other forms of specialized knowledge, knowledge spillovers remain narrow and imitative. The experience of the developed countries indicates that research is undertaken by the specialized research institutes/universities and then the knowledge so gained is commercialized by separate firms.²⁷

Chambers of commerce and trade bodies which could have been influential in filling the information gap have been politicized largely through the control of the government bureaucracy once again for its own rent seeking.

d. City Administrations Unfriendly to Small and Trading Businesses

Retailers especially the smaller ones all complained of a lack of quality space. Supply was always short and it was always uniform. A shop was always a small little street front space with no parking, poor access and no room for back office facility. Shopping malls and warehouses were not available anywhere and zoners remained unfriendly to them.

Poorer retailers who could not afford structured shops had to remain mostly in the informal market. Most of their operations were allowed only in the poorer crowded areas of town. Urban administrations would not allow them into better parts of town.

Even the manufacturing units were operating in owned premises often required to even plan for owned warehouses and the supply of

26. Even when bank financing requires a feasibility, investors tend to copy some else's often outdated feasibility.

27. The lack of a research and innovation culture constrains Pakistan even in the policy space (see Haque 2006 a and b)

housing to labor. Given the small size of the businesses, rented premises would be more efficient.²⁸ Such rented space is mostly flexible warehouse space on the outskirts of cities. But that land has been taken by housing societies.

The presence of cantonments within the city hinders commercial activity. More than half of most cities are cantonments and administered by the army. Not only does this split city administration, cantonments also remain basically unfriendly to commerce and business. For example, Sargodha cannot have high-rise towers due to location of PAF base within city limits. This obviously increases cost of doing business and thus constrains entrepreneurial activity.

Sialkot may be the only city that has the potential of being a merchant city; businessmen have joined together to build an airport and roads that might help their city. However city and the cantonment administrations are still an impediment to the development of a merchant city. For that we will have to wait for a coherent city administration where cantonment and city divisions disappear and merchants and citizens own the city. Today, cities have not developed as business clusters because they have not developed as attractive sources of migration. It is important to note that immigrants especially from competing cities may bring in fresh skills and ideas.

Another impediment that businessmen from Sialkot specifically mentioned during the discussion was that the commercialization rate is very high in Sialkot. The commercialization rate, according to them, is even higher than that prevailing in Lahore. This prevents all sorts of construction needed by business from happening.²⁹

e. Poor Legal Framework

To begin with all pointed to the lack of rule of law a basic institution underpinning business. No one seems to be sure of the framework of rules in which they are operating. Rules such as property rights, zoning, and licenses are often changed for individuals on the basis of their clout. In that sense you are never sure of the market environment you are operating in.

There is no faith in the legal system to enforce even the basics of business-property rights and contracts. Several examples were given. A few are worth highlighting:

- Businessmen prefer to use owning rather than renting premises because of poor state of contract enforcement. The participants pointed out that when a business gets established, the landlord may demand either a significant increase in rent or demand that place be vacated. On vacation of the premises, the place is rented out to a competitor of the previous incumbent or at times the owner may himself commence the same business at the same place. In developed countries the practice is that the landlord, if he wants the premises vacated, is not allowed to use the premises for similar kind of a business for a certain length of time.

28. Especially in initial years when the prospects of the business are supposedly uncertain, startups could benefit by being in rented accommodation.

29. Thus for example a city of exporters, Sialkot has no hotel.

- Participants of the focus group discussion held at Sialkot complained that the labor trained by one employer, either moves to another employer or opens up his own firm. Contracts cannot be credibly written to protect employers as well as employees and allow gains to be captured so that happy employees lead to business growth. Poor contracting arrangements also prevent payment mechanism that benefits the employers such as stock options and bonuses.
- Suppliers do not meet commitments in terms of delivery schedule and at times quality as well. But no quick legal remedy is available. On the other hand buyers do not pay as per schedule or at times give checks that are not honored. Though there is a law that entails punishment against bounced checks but the law has so many loopholes that defaulter is rarely punished.

f. Lack of Trust and Social Capital

Sialkot especially noted how the lack of governance and a quality legal and justice system was impairing business conditions. They pointed to an extreme lack of trust among their business community. In their attempt to hide business information they maintain mailing address and bank in other cities.

We were told that an important reason that businesses remain owner operated and do not grow is that professional employees cannot be trusted. An employee who gains any knowledge of their business is easily able to replicate it with stolen business information. Cut-throat competition uses all means to cut into each other's markets and buyers. This impedes cooperation among them to better the market.

As discussed in section 1, knowledge spillover especially that of tacit knowledge tends to be localized through development of clusters of similar industries. Such clusters have developed in cities like Sialkot, (surgical and sports goods industry) Gujrat and Wazirabad (light consumer engineering) Sargodha (agribusiness and light electric) and Faisalabad (textiles). However, this clustering has not led to any real development of ancillary activities that will facilitate business growth. Examples of such ancillary activities would be such as institutionalized skill development and knowledge development and sharing. It should be interesting to research into why this has not happened. My hypothesis is that this is a by product of the lack of social capital and the inability to develop a merchant city.

g. The Constraint of Financing

Small businessmen have little recourse to bank financing. As noted above they do not use other financial instruments. Almost all the smaller businessmen were of the opinion that banks lend only to big borrowers for non-commercial and political reasons. As noted above this was true in the past before banks were privatized.

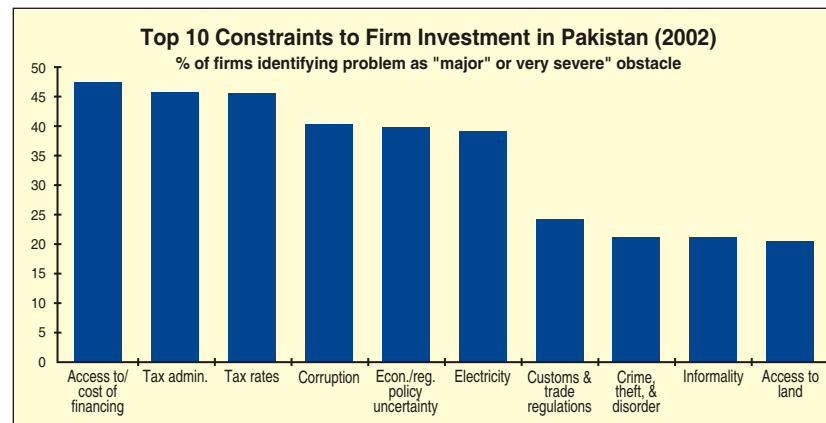
Only one person from Sialkot out of the approximately 50 people we interviewed in all, had had raised funds through the stock market. They were of the view that their size is too small to allow them to warrant entry into the stock market. However, they agreed that they did not know enough about financing through the stock market. Raising funds from the stock market is also not preferred to avoid sharing important business information with competitors and tax authorities.

There was also a feeling that the SECP(Securities and Exchange Commission of Pakistan) and its cost may also be unfriendly to this segment.

h. Why there is no Consolidation?

In most new markets large numbers of businesses start up but over time there is a tendency to consolidate. In all the markets that we talked to this was not observed. A large number of similar small businesses provide very small fractions of the demand.

While we did not get a good answer to the question on 'why consolidation is not taking place?' we did get some indicative answers. It seems that a combination of the factors that we have assessed above is retarding business growth and hence any one firm to grow to a level where that firm will dominate. The following diagram highlights the top ten constraints identified by the World Bank, to businesses in Pakistan in the year 2002.



7. Conclusion

If entrepreneurship is to develop and be at the root of development in the country, it is imperative that there must be deep government reform which limits rent seeking, encourages innovation and fosters enterprise. The following is recommended:

a. Reinventing the Role of Government and Ensuring Rule of Law

Much of the historical experience and global research has shown that no society can progress without developing rule of law. Once rule of law is strictly in place, the state has no favorites and rent seeking efforts dissipate. This is the basis of moving from a system of competing for state favors to one of market competition.

The role of government must be to institutionalize the rule of law, provide access to justice to all its citizens, maintain public law, and a legal and judicial system that enforces contracts. The government machinery that in the past would provide these magisterial goods has, for too long, given a higher priority to development projects. The result is that market competition does not take place on the basis of product development and consumer preferences but on unfair practices many of which involve influencing the government. This environment has eroded trust, society

and the community. Returning the government to take seriously its magisterial function has to be an important first step.³⁰

b. Removing the Instruments of Rent Seeking

If we accept the analysis presented above, several areas of reform suggest themselves;

- There is a need to stop the policy of 'sector-picking' and providing incentives to support it. This would mean opening out the economy including removing tariff protection for favorites. No industry or group would be protected through government subsidy. Defaulting businesses and those that had experienced market difficulties would be dealt with according to market means even if it means a business failure.
- The civil service and all government service will have to be reformed so that the malaise of corruption and rent seeking can be eradicated. This will obviously involve setting government salaries in line with the market while eliminating all non transparent means of payment either through perks or cheap land. All payment should be in cash and in one lump sum and no tax-free unobservable allowances. Needless to say this will have to be supported with open entry into the civil service at all levels.
- Government must get out of the business of land development. All land that the state wishes to make available for development should be auctioned off and developed by the private sector. None of it should be developed by state agencies, and given to any government at cheap prices.
- The cooperative housing society act should be abolished or amended to disallow it from being used for land development for urban housing.
- Land acquisition law should be tightened so that it cannot be used for developing any housing whether private or public.

c. A New Growth Strategy

There is an urgent need to shift the growth paradigm in Pakistan. 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 a neglect of governance and the development of rent-seeking. Talent and merit were disregarded by that system.

Economists are now emphasizing that for self-sustaining growth, such institutions need to be built that preserve individual freedom, provide security, and facilitate market transactions; the government merely provides these institutions, allowing markets to determine where economic activity goes. This is a meritocratic framework where

30. This is a paradigm shift which current development thinking must achieve.

success is determined purely by the marketplace, and where government efficiency is also judged by how well it develops the governance infrastructure that facilitates the market.

Given these new findings in economic research, Pakistan's growth strategy should be the subject of some debate. There may be a case for moving away from the current focus on government planning, production, and mercantilism to a more market and commerce based approach. The new approach would be more aligned with globalisation, creativity, and innovation.

The new growth strategy must include all sectors in particular the home goods sector which has till now been neglected and discriminated against.

d. Building Growth Cities

Haque (2006c) notes that "Cities grow when they are allowed to function as decentralised, coherent administrative units that are run for the advancement of commerce. It is then that they are engines of economic, cultural and human growth". To achieve this:

- Policy, research and thinking needs to move away from a space-less approach to development by integrating the role of cities as engines of growth.
 - Decentralisation needs to be strengthened to allow cities adequate ownership of their land and resources. This must mean an adequate definition of city limits with exclusive city ownership by the city governments on behalf of its citizens.
 - Fiscal federalism needs to be urgently adopted for city growth.
 - The zoning paradigm needs to move away from its current emphasis on upper class housing to one that recognizes the diversity of the functions of a city.
 - City centers need to be developed for dense mixed-use. Government ownership of city-centre land needs to be reduced if it is retarding downtown development. Commerce is to be given priority in city centers.
 - Zoning needs to be based on clear transparent processes based on open citizen consultations.
 - Culture and education need to be included in zoning.³¹
- City management should be professional, consultative and accountable. Cities must be able to hire out of their budgets without federal hiring restrictions such as the Unified/National Pay Scales and mandatory positions for the federal civil service. Moreover, decision-making must be based on open consultative processes.
- Commercialization policy should be reviewed to remove the bias towards engaging in business.

³¹. Currently while we build leisure clubs for the privileged routinely, there is no space for libraries, theatres, community centres, museums, and art galleries.

This simple reform agenda will reduce the current high level of rent-seeking in our cities and lay the basis of commerce and creativity which will fuel sustainable growth.

e. Identifying 'Lemons'

Nobel Laureate, George Akerlof (2001) was the first to point out that asymmetric information between buyers and sellers, as to the quality of good in question, discourages trade. He noted that the seller knows that buyers information about the quality of good in question is poorer. Given this knowledge the seller attempts to sell poor quality goods as better ones and this makes the buyer wary of buying. In the extreme case the asymmetric information may lead to the collapse of the market. Number of market structures have emerged that allow the markets with asymmetric information to function either by signaling the quality of the good in question, (for example branding), or assuring the buyer (using Guarantees/warranties) that he is not being taken for a ride.

i). Brand Development and Brand Management: Erdem and Swait (1998) argue that when consumers are uncertain about product attributes firms may use brands to inform consumers about product attributes. This reduces uncertainty by lowering information cost and the risk perceived by consumers and thereby encourages trade. Pakistan can boast of very few brands. We feel that to give a significant boost to entrepreneurship, Pakistani businessmen need to invest in brand development and brand management. The two, among other things call for, having some uniquefeature of the product, communicating the feature to the customers and ensuring that consumers do actually find that feature in the product. In sum this calls for developing and maintaining a certain quality.

ii). Guarantees/Warrantees>Returns: Very few sellers, in Pakistan, issue guarantees in the first place. The ones who do offer guarantees quite often fail to honor the same in letter and spirit. To reduce the risk of the buyer and thereby encourage trade our businessmen need to offer guarantees more often and honor the guarantees as well without fuss.

f. Releasing the Energy of the Domestic Sector

Development is a city phenomenon and strongly founded on domestic trade. Of course, openness has to be maintained to allow cities to find their own depth and get the right signals from the international market. Such open cities and markets develop rapidly, learn from the global knowledge pool, and find business processes and brand names that can compete in the global market. Moreover, it needs to be realized that Pakistan has a very large market of a 160 million people waiting to be exploited. For decades, this fact has been ignored in policy because of the focus on production and exports! The following is recommended to boost entrepreneurship at the domestic level:

- There is an urgent need to sensitise all cities and small town administrations about the importance of domestic commerce.
- These administrations should review their zoning and commercialization rules and regulations to facilitate and promote commercial development.

- Every main town in every district should think about establishing the following:
 - A market or a mandi for agricultural produce;
 - Storage;
 - Warehouses, modern shopping malls, and retail places;
 - Upgrading outdated and old commercial activities;
 - Hotel and leisure spaces (theatres, cinemas, etc.);
 - Sporting and culture;
 - Small stalls, khokhas (kiosks), and rehri (barrows) in every area of the city; and
 - Offices and apartment blocks in close proximity of the shopping and business districts.
- Commercial activities may be treated at par with industry in terms of taxation and other government policies.
- Domestic commerce should be made pro-poor by allowing the poor some space for entrepreneurship in all Pakistani cities as well as in all the best areas in Pakistani cities. Currently, none of the fancy markets in the main cities of the country has any space for poor entrepreneurs.

Domestic trade promotion will allow Pakistan to exploit its large market, as well as offer employment opportunities to a large and growing youth population³² in the country. For this reason a policy framework for the promotion of domestic commerce is urgently required. It is also a matter of priority that all levels of government collaborate to promote domestic commerce.

Finally, what is proposed here is a broad based reform agenda that arises out of a political economy analysis of the economy of Pakistan. Needless to say, such a reform will face huge opposition from vested interests.

There is also an urgent need to develop ideas on how such a reform could be made acceptable and the control of vested interests weakened. For this to happen there must be much more autonomous research and debate on these issues. For too long has the academia been slavishly following the government and the donors, researching the earlier paradigm of growth planning and sectoral development. Donor-led consulting has virtually destroyed academic freedom and is keeping thinking in the country path dependent.³³ If there were enough academic research and debate on fresh approaches to growth through entrepreneurship, ideas for change and development would definitely take root.

32. 50 percent of the population is "less than 19 yrs". Progress on the spread of education has been slow leaving this bulge largely unskilled and hence with limited employment possibilities.

33. Poorly paid academics devote all their time to donor funded consulting work. This work is driven by the need to lend and tinker with the existing government policy. The donor likes no research that might upset the client the government.

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Dr. Nadeem Ul Haque - Brief Resume

Vice Chancellor
Pakistan Institute of Development Economics,
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PROFILE

- Wide-ranging operational experience over 22 years at the IMF.
- Strong background in economic analysis and policy development, reflected in numerous publications in academic and policy journals and conference participation.
- Extensive research and experience of public sector reform and restructuring: led organizational reform and efforts for nationwide deregulation in Sri Lanka.
- Skilled public speaker with ability to develop and lead public debate in diverse topics.

MAJOR SKILLS AND ACHIEVEMENTS

- Initiated and successfully led a Central Bank modernization project in Sri Lanka.
- Initiated and successfully led three initiatives in Sri Lanka: deregulation of the private sector, financial sector reform, and education reform.
- Led the IMF team for developing training courses.
- Published 2 books and over 50 papers in major journals and edited volumes.

CAREER HISTORY

- Vice Chancellor, Pakistan Institute of Development Economics, Quaid-i-Azam University, Islamabad - January , 2007 to date.
- Acting Chief Economist, Planning Commission, Government of Pakistan June 28, 2006 to 24th Nov. 2006.
- Member, Planning Commission, Government of Pakistan - April 26, 2006 to date
- Trade Policy Advisor to the Minister of Commerce, Government of Pakistan - August 2005 April 2006.
- Advisor IMF Institute: Training and research activities. Leading training missions to African and Asian countries - Sep 2004 to August 2005.
- Senior Resident Representative of the IMF in Egypt- Sep 2002 to 2004.
- Senior Resident Representative of the IMF in Sri Lanka - Sep 1999-to Sep 2002
- Advisor, IMF Institute -1997-99

EDUCATION

- Ph.D. (Economics) University of Chicago, Chicago, Illinois, 1986
- Thesis Supervisor: Gary Becker, Nobel Laureate
- M.A. (Economics) University of Chicago, Chicago, 1980
- B.Sc.(Econ) London School of Economics, London, 1974

Questions for Focus Group Discussion on Entrepreneurship

1. **Starting a Business**

- i. What kind of business are you in?
 - i.1 Fixed asset?
 - i.2 Mobile?
 - i.3 Non-traded goods? Traded goods?
- ii. Where did your business idea originate from? What was the process that led you to it? How did you think of it? What were your sources of information? Who were your advisors?
- iii. Is the idea original? Did it start a market? Or did u imitate others?
- iv. What were you doing before this?
- v. Did you have any business failures before this? If so move to business failure section.
- vi. Did you do a feasibility analysis? Did you do it yourself?
 - vi.1 Did you get any expert help? How long did it take you to take up to set up business?
- vii. Any permission required? Any bribes to be paid? What government interference did you have?
- viii. What was your source of financing?
 - viii.1 Did you use any formal financing or Informal financing?
 - viii.2 Do you have any equity partners?
- ix. How did you choose this location? Reasons for your choice?
 - ix.1 What were the other choices? Did you have many choices?
 - ix.2 Is it easy to find business locations?
 - ix.3 If a mobile business, any impediments to your movement? Such as Regulations? And/or Permission? And/or Bans?
- x. Do you own your premises or rent? Which is more advantageous?
- xi. How long did it take to start actual market transactions from the inception of your idea?
- xii. During this period what impediments did you face?
 - xii.1 How many government regulations did you have to contend with?
 - xii.2 What market imperfections did you face?
- xiii. What kind of labor if any did you need? Anyskills? Were they freely available?
- xiv. In your entire startup phase did you need any expert skills say for making financial projections, design, marketing etc.? Were they available? Did you use them?
 - xiv.1 Would it have helped to use them?

2. Operating Business

- i. How long did it take to recover your capital?
 - i.1 Have you paid off your loans if you had any?
 - i.2 Are you paying your partners a return if you had any? What kind of a return?
- ii. What marketing techniques and resources do you have at your disposal? Expert advice? Specialist firms?
 - ii.1 Method for marketing?
 - ii.2 Do you use the media? If so what kind and how?
- iii. Explain the sort of market you operate in? What sort of a market do you operate in? Is it highly competitive?
 - iii.1 Or are you working in a differentiated market where you have large share of the market?
- iv. Where do you fit in the value chain? What sort of input and output markets do you serve? Are they competitive? Or are you locked into a market with a big player?
 - iv.1 If the latter, how is it affecting your business? Do you have room to grow?
- v. Do you use the financial markets?
 - v.1 Formal Banks, stocks?
 - v.2 Informal money lender committee?
 - v.3 Insurance?
 - v.4 Hedging instruments?

3. Cost of Doing Business

- i. What affect does the government have on the running of your business?
 - i.1 Any inspectors?
 - i.2 Any regulatory reporting requirements?
 - i.3 Labor Laws?
 - i.4 Taxes and tax collections?
 - i.5 Bribes?
- ii. Utilities? Availability Irregularity? Price hikes and expenses?
- iii. Infrastructure? City and government infrastructure? Is it adequate? How can it be improved?
- iv. Uncertain government policies?
- v. Remoteness from big city?
- vi. Is the federal government, provincial and city government helpful to your business? Discuss the role of each separately?
- vii. Poor governance, does it affect your business? Law and order etc.
- viii. Country perceptions (travel advisory) how does that affect you?
- ix. Lack of tourism?

4. Expansion

- i. Have you expanded your business?
 - i.1 Size of business?
 - i.2 No. of locations?
 - i.3 No. of employees?
- ii. What factors have helped your expansion? Finance? Market development? Marketing?
- iii. What factors constrain your expansion?
- iv. Does the government policy facilitate expansion?
 - iv.1 Which level of government facilitates expansion? City federal provincial?
 - iv.2 Which level of government hinders expansion? City federal provincial?
- v. Do you have any research capability? Market research? Product research?
 - v.1 Would you require IPR to protect your product?
- vi. Do you have expert advice for expansion?
- vii. Have you been bale to develop brand name? Have you tried? What hindered you if you tried?
- viii. What changes in policy and regulation do you want changed for you to expand?

5. Business Failure

- i. What factors were responsible for failure?
 - i.1 Bad planning?
 - i.2 Lack of finance?
 - i.3 Poor market conditions?
 - i.4 Lack of advice?
 - i.5 Bad government policy and regulation.
 - i.6 Was exit easy? What affected poor quality exit if it was of a poorquality?

Annex. 2

Focus Group Discussion with Entrepreneurs from Lahore

A focus group discussion involving Vice Chancellor PIDE and entrepreneurs of Quaid-i-Azam Industrial Estate, Kot Lakhpat, Lahore, was held on March 03, 2007. Eleven Small and Medium entrepreneurs involved in manufacturing of various products were present (list attached). The products being manufactured by these entrepreneurs include Polypropylene bags, Pharmaceuticals, Bottles, Socks, Herbal medicines, Bread and Snack food items, Cold Craft Chain, Auto parts, and textile finishing. The crux of the discussion is presented below.

How the business was conceived:

- Some entrepreneurs had inherited the business.
- The entrepreneurs who started the business on their own, their reasons included being employed in the same field, being into the field as trader and being advised by the banker or enjoying academic background of the field (Pharmaceuticals).
- Few entered the field by doing research about the field or the project in question.
- The entrepreneurs complained that no data-base is available in respect of potential fields/ projects from any governmental agency. Feasibilities available with SMEDA are outdated and useless.
- Chambers/trade bodies should provide the kind of data/research referred above (PIDE).

Failure of entrepreneurship initiatives:

- Lack of home work/research before undertaking the project.
- Lack of home work/research stems from lack of education.
- Muslims, before the partition of India were generally in government service. Hence the lack of business acumen.
- Early entrants became giants because of excess demand then but now success without home work/research is not possible.

Duration: From conception of the entrepreneurial idea to becoming operational

- Takes 2-3 years.
- Reasons for long lags in operationalising a business:
 - NOC from host of departments amongst whom there is total lack of coordination. For example, despite NOC from ministry of Health, Pharmaceutical firms were allowed to open up only after the decision of Ombudsman in their favor.
 - Financing from the bank takes time (1-2 years).

Financing:

- Most of the entrepreneurs mainly use equity funds.
- Lack of interest in bank financing:
 - Participants considered bank financing costly.
 - Banks lend for short and medium term (1-5 years). Participants think that a new firm needs finance for 10 years or more.
 - Volatility of lending rates since 9/11 has made the entrepreneurs wary of bank financing.

- Big borrowers have been defaulting on bank loans while the share of SMEs in bank defaults is negligible. Still banks are reluctant to lend to SMEs.
- Informal finance is not being used as it is costlier than even bank lending.
- Finance from friends and family:
 - Is used quite often.
 - Family finance is mostly un-documented.
 - Non documentation causes problems in case of death of the borrower or lender.
 - The solution is succession planning, but that is considered a taboo.
- Some entrepreneurs neither use borrowed funds nor sell for credit.
- SMEs and Stock Market
 - Entrepreneurs are generally not using the stock market for raising funds.
 - The entrepreneurs believe that the stock market is for the big players.
 - Entrepreneurs' lack of awareness, about the functioning of the stock market and the technicalities of raising funds through the stock market.
 - Entrepreneurs have not thought of using consultants to raise funds from the stock market.
 - Entrepreneurs do not take into account the opportunity cost of equity.

Warehousing:

- The entrepreneurs are mostly using either a rented house or some closed industry as a warehouse.

Expansion:

- 'Limited managerial capacity' is the reason for not expanding - the entrepreneurs cannot handle too many tasks themselves.
- The entrepreneurs are not inclined to delegate rather they insist upon doing most of the tasks by themselves.

Institute for skill development:

- No institution for development of middle management/ skill development.
- Government should establish more technical training institutes. For private sector this is not a remunerative activity.
- The institute established for textile industry by the govt. and handed over to the industry for running is not functioning (PIDE).

R & D:

- Entrepreneurs are generally not conducting R&D. According to entrepreneurs production cost being high and margins narrow R&D is not affordable. Major reasons for cost being high include: high utility prices and minimum wage fixed by government.

Legal Framework:

- Suppliers do not honor agreement/commitment. Legal framework does not provide much facilitation in this respect.
- At least 22 government departments visit for collection of different taxes/revenues/seeking information. The bribe money per department ranges between RS. 2000-3000 per month. The Auto part maker said they have to handle 57 departments.
- 1-2 employees remain permanently engaged in dealing with the government functionaries. Approximately half of the business time is spent in dealing with the government officials at various levels and paying visits to provincial/Federal Capital.
- The annual collection from the industrial Estate is around RS. 200 million. The offer of depositing the amount by the industrial estate, in return for zero visits by tax officials was rejected.
- Entrepreneurs are generally are not consulted while framing laws that affect them. There is also no/little consultation while signing international treaties like WTO/SAFTA etc.
- Recovery of amount due from the buyer is difficult. Though there is a law against dishonored checks but the law has many loopholes that make it ineffective.

Trade Unions:

- The provision of the IRO that 25 percent of the trade union members can be non-employees cause problems.

Policy to avoid frequent visits of government officials:

- There should be a single tax that includes the tax payable to all the departments.
- Firms selected for detailed income tax audit should be drawn through balloting. Discretion of the ITO to select the firms for detailed audit (143-B) empowers him to ask for bribe money.

What key policy change is required for entrepreneurship to flourish?

- Get rid of bureaucratic clutches.
- Single tax/One window operation.
 - Officials from EOBI/Social security visit the factories, why not one person on behalf of both the departments.
- Tri-partite arrangement for running industrial estate.
- Government support should R&D.

What level of government is friendly?

- Currently Provincial government, due to CM's personality. However bureaucracy does not implement his orders.

Use of Consultants:

- The use of consultants is rare. Occasionally they are used for obtaining finance but not for marketing or HR activities.
- Non-use of consultants is due to lack of awareness. However those who are growing their growth is attributable to the advice of consultants.
- If expensive consultants can be used group-wise (PIDE's suggestion).

Outsourcing

- Not many entrepreneurs are outsourcing their activities.

Compliance with WTO etc.

- If an entrepreneur sells to a foreign name of repute, government agencies ask for wealth of information regarding cost, packaging etc. The exporters fear that if the product does not conform to the standards the production ready for shipment will have to be dumped.

General

- Relationship between business and government is adversarial with both blame each other.
- The size of informal/undocumented economy is greater than the documented economy due to tax evasion.
- Entrepreneurs do not display sign boards on business premises to avoid tax payers. If boards are installed officials issue challans/warrants against the entrepreneur without even meeting him.
- Policy announced is quite often not implemented no notification is issued to give affect to the policy announced.
- In case of medicines consumer prefer drugs produced by MNCs/Brand names because here the govt. does not provide support to generic names. In US FDA backs generic drugs.

List of Participants

PIDE:

Dr. Nadeem Ul Haque	Vice Chancellor
M. Idrees Khawaja	Research Associate

Entrepreneurs:

1. Mian Nauman Kabir	President, Board of Management, Quaid-i-Azam Industrial Estate
2. Sajid Latif	Director, Standard Hosiery
3. Syed Tariq Jaffery	Executive Director, KoldKraft
4. Babur Mahmud Chaudhry	MD, Pharmacare Laboratories
5. M. Ayub Shaikh	Chief Executive, Asmy Dyeing Mills
6. Amjad Ali Jawa	MD, Wilshire Laboratories
7. M.I.Khurram	Chief Executive, Comfort Group of Companies
8. Haroon Chaudhry	Chief Executive, Bunny's Limited
9. Ahmed Khan	Director Systems, Inter Market Knit
10. Hakeem Muhammad Usman	Chief Executive, Marhaba Laboratories
11. Iqbal Baig Chughtai	Chairman, Plaspack

Annex. 3

Focus Group Discussion with Entrepreneurs of Sargodha

- A focus group discussion involving Vice Chancellor PIDE and entrepreneurs of Sargodha was held on March 07, 2007. Small and Medium entrepreneurs involved in manufacturing of various products were present (list attached). The products being manufactured by these entrepreneurs include Furniture, Food Stuff, Cosmetics, and Auto parts, Electrical Switches. Besides distributors of fresh milk, pharmaceuticals, garment and watches (distribution) and construction consultant were also present. The crux of the discussion is presented below.

How conceived?

- About half of the participants had started the businesses themselves upon the advice of friends and family members. While others had expanded the family business. Little formal research was done before initiating the business.
- One entrepreneur being an electrical professional had established a plant for manufacturing of electrical switches.

Will you be a leading business man in 20 years from now?

- Manufacturing business is down due to cheaper imports from China.
- Trading business is down due to motor way. Now Lahore is approachable for buyers from outskirts of Sargodha, besides smaller towns have developed their own distribution network. Therefore government should incentivize business in Sargodha.
- Why not move to Lahore if business is on the decline in Sargodha?
 - Social costs of migration from one's native town is quite high. Besides cost of living is low in a smaller city.
 - One possible solution to motorway problem: Build Discount Malls (PIDE)
- Q. Why in business if incurring losses?
 - Entrepreneurs: Just surviving.

China Factor

- Our product costlier, because:
 - Duty on raw material is greater than that on finished goods.
 - Labour in china is more efficient and cheaper as well.
 - Relatively higher utility prices in Pakistan.

Use of consultants:

- Generally not used, reasons for non-use include:
 - Lack of awareness about the benefits involved
 - Use of consultants requires money
 - Lack of attitude
 - Non-availability

Innovation/Imitation

- Except for one, others are dealing in established products. The lack of innovation is due to weak property rights. People quickly copy the idea. No legal remedy is available to the innovator.
- Besides the laborers trained by one employer move to his competitor, with the previous employer having no recourse to law. This reflects weak property rights.

Did any entrepreneur encountered failure?

- One entrepreneur encountered failure, Reasons for failure:
 - Lack of knowledge and lack of sufficient homework.
- In general, formal feasibilities are not prepared by the entrepreneurs before undertaking a project.

Financing

- Bank financing is generally not used, reasons for non-use include:
 - high cost
 - non-availability for the small entrepreneurs
 - Bank finance is available only to favoured ones,
 - besides the procedure is lengthy and cumbersome.
- Interest rate should be KIBOR plus and same for all borrowers.
- In US even mortgage financing involves bargaining. (PIDE)
- Q. Would the business grow if finance is made available free of cost?

Entrepreneurs: No, financing is not the only element in the success of a business.

Use of Stock Exchange for Raising Funds

- Not Used, reasons include:
 - Lack of knowledge regarding technicalities of raising finance through stock market.
 - Stock market is for big players.

Suppliers Credit: Easily available, Maturity varies with nature of the product.

Business Premises

- Entrepreneurs prefer owned premises, because of weak property rights - once the business stands established landlord demands either unreasonable rent or asks for vacation of the premises.

Characteristic of Sargodha

- Mixture of rural area and city: Business activity: Mostly Agriculture and Trade, Few industries, but on small scale only.
- The entrepreneurs agreed that undertaking industrial activity is not the job of the government but complained about the absence of level playing field e.g. tax holiday is provided on selective basis.
- One major reason for the lack of industrial activity is the air base: This point to the need of locating military activity outside the city limits.

- **Labour**
 - Skilled labour is not available in sufficient quantity
 - Technical training institutes are not available
- **Why your market is just Sargodha not the whole of Pakistan?**
 - Thinking horizon is smaller
 - When big orders arrive, labour exploits the entrepreneur.
- **One advise to government to improve entrepreneurship**
 - Rule of law and level playing field
 - Duty regime should not change frequently
 - Raw material not produced locally should not carry any import duty
- **Dealing with how many government departments:**
 - Around 10-12
- **Why no Consolidation?**
 - Business in Sargodha is already on the decline
 - Lack of awareness
 - Q. Is there a legal problem. Entrepreneurs: No
- **Establishment of business**
 - Land is available, there are problems with land title but these are not of acute nature problems but not acute.
- **General:**
 - Tax office moved to Faisalabad. Entrepreneurs will have to go to Faisalabad. Visit to Faisalabad to resolve petty problems will consume important business hours.
 - The poor conditions of bazaars are due to inefficiency of local leaders.
 - The state of city amenities is a hurdle to business growth. Taxes from city should be spent on city.

List of Participants

PIDE:

- | | |
|------------------------|--------------------|
| 1. Dr. Nadeem Ul Haque | Vice Chancellor |
| 2. M. Idrees Khawaja | Research Associate |

Entrepreneurs:

- | | |
|----------------------|------------------------------|
| 1. Zafar Iqbal | Food Stuff Exporter |
| 2. Faisal Issani | Food & Cosmetics |
| 3. Shaheed Iqbal | Auto Parts |
| 4. Rana Abdul Hafeez | Electric Switches (Importer) |
| 5. Fareed Iqbal | Construction consultant |
| 6. Nasir Butt | Auto Parts |
| 7. Mirza Nazeer | Furniture |
| 8. Shaikh Zia Ullah | Pharmaceuticals |
| 9. Mian Aslam | Fresh Milk |
| 10. Shaikh Sikandar | Garments |
| 11. Ali Murad | Pulses (Wholesaler) |
| 12. Babur Ahmad | Furniture |

Focus Group Discussion with Entrepreneurs of Sialkot

A focus group discussion involving Vice Chancellor PIDE and entrepreneurs of Sialkot was held on March 08, 2007. Small and Medium entrepreneurs involved in manufacturing of various products were present (list attached). The products being manufactured by these entrepreneurs include Surgical instruments, Sports goods etc. The crux of the discussion is presented below.

How the business was conceived?

- Most of the entrepreneurs have imitated. Some manufacturers even do not know where the instrument (surgical) is used but they are still able to produce the instrument because they are good at imitation.
- One entrepreneur entered the field of certification (ISO 9000) because of being an employee in a similar organization earlier.
- In general, little business research, was conducted before entering the field.

Why no Consolidation?

- Cut throat competition does not allow consolidation
- Setting up a firm is very easy
- An employee takes an employers knowledge and opens up his own firm. This reflects weak contract enforcement.
- Genetic: Everyone wants a solo flight, Lack of attitude towards delegation.
- Industry is vendor based: The person who supplies raw material, later on opens up his own firm.

Financing

- Bank financing is not available for new entrepreneurs. Mostly equity funds are used.
- Interest rate is high
- Q. If funds are made available would the business grow? Entrepreneurs: No, Real estate prices will shoot up.
- Why not Stock Market is not used for raising funds:
 - Lack of knowledge about the technicalities of raising funds from stock market and smaller size of the entrepreneurs.

Industry Characteristic

- Skill based (imitation), not knowledge based.
- Q. Why Faisalabad is ahead of Sialkot.
- A. Faisalabad has:
 - Chosen bigger product.
 - More influence in government, incentives available; e.g. 6 percent subsidy for R&D. No such help to Sialkot.
- **Consultants**
 - Neither used, nor required.
 - Owners themselves know everything. This could be a misconception due to lack of awareness.

- SMEDA: Initiated its activities very late. Entrepreneurs are not very clear about its effectiveness.
- University being established with collaboration of Sweden is expected to provide the required technical support.
- **Labour**
 - Shortage of skilled labour
 - Not very disciplined
 - Trained by one employer moves to another firm or opens up his own firm.
 - Child Labour:
 - The system of ustad-shagird used to provide vocational training. Child labour has been eliminated but vocational training institutes have not come up to fill the gap.
- **Corruption**
 - First duty is imposed then drawback is given. Bribe money has to be offered on both counts.
 - What the government is collecting more than that was offered by the chamber in lump sum in return for sparing the business man from contact with tax officials. The offer was not accepted.
- **Say in policy making**
 - Suggestions sought but not incorporated in policies.
- **Dealing with government departments:**
 - Number of Departments: 20 plus
 - Bribe money paid: No clear answer.
 - Time spent: One employee dedicated by bigger companies.
 - One window operation is required.
- **Town Planning**
 - Bad, Reason: Civil & Military bureaucracy is responsible.
 - Why not high rise towers:
 - Commercialization rate is very high (20 percent of price fixed by authorities), this is even more than that prevalent in Lahore. Besides the minimum price fixed is very high.
 - Is Sialkot Cantonment of any help in business? No accept for providing residence for some businessmen.
- **Why good hotels are not coming up?**
 - High commercialization rate.
- **Airport**
 - Funds committed by federal and provincial government have not been fully realized. Given the shattered trust businessmen are not willing to make further voluntary contributions.
- **One single policy that will facilitate business activity**
 - Govt. should contribute towards city development chamber will ensure contribution from entrepreneurs.
 - Better Law and order situation
 - Speedy Justice for all
- **What level of government is more friendly?**
 - None

- **Subsidy demand:**
 - None, but level playing field is required.
- **R&D**
 - Not much R&D is being conducted in engineering perspective, because industry is skill based (imitation) rather than knowledge based.
 - In marketing perspective research is being undertaken, entrepreneurs go abroad to search for markets.
 - Entrepreneurs collaborate with established foreign brand names. Receive guidance from foreign collaborators.
- **Business Failure: Yes because of:**
 - Cut throat competition
 - Lack of corporate culture
 - Lack of knowledge/proper homework

List of Participants

PIDE:

- | | |
|----------------------|--------------------|
| 1. Nadeem Ul Haque | Vice Chancellor |
| 2. M. Idrees Khawaja | Research Associate |

Entrepreneurs:

- | | |
|----------------------------|---|
| 1. Zia Ullah Mirza | Surgical Instruments, Exporter |
| 2. Arshad Ahmad | Sports Goods, Exporter |
| 3. Asim Kabir | Quality Assurance Certification (ISO 9000 etc.) |
| 4. Shahzad Gul | Surgical Instruments |
| 5. Hafiz Noor Qamar | Surgical Instruments |
| 6. Khawar Idris | Foot Wear |
| 7. Ghulam Mustafa Chaudhry | Sports Wear |
| 8. Chaudhry Munir | Surgical Instruments |
| 9. Nasir Amin | Metal Works |
| 10. Ghulam Mustafa | Metal Worksh |

Annex. 5

Focus Group Discussion with Entrepreneurs of Gujranwala

A focus group discussion involving PIDE and entrepreneurs of Gujranwala was held on March 09, 2007. Representatives of various traders' associations involved in trading of different products were present (list attached). The products being traded include: Electronics, wheat, vegetable oil, Jewelry, Homeopathic drugs, shoes and general purpose items.

How the business was conceived

- Some just joined the ongoing family business while others had started upon the advice of friends and family. However little research was done before entering the field.

Financing

- None of the participants are using bank financing some did try but failed to meet the requirements.
- Collateral valuation is unfair
- Not possible without paying bribe money
- Informal finance from friends and family is being used
- Occasionally finance from money lenders @ 10 percent per month is being used.

Impact of China factor upon business

- Chinese goods have adversely affected the Pakistani products. Reasons include:
 - Smuggled goods from China
 - Low utility prices in China
 - Efficient labor in China (PIDE).

Conception/Commencement of a business

- Sufficient knowledge is not available. No training institute for the purpose.
- Delays/bribe money involved in provision of electricity, water connection etc.
- Hurdles/bribe money involved in issuance of licenses where required. However most of the businesses do not require license for setting up the business.

Marketing

- Mostly by way of hand-outs

Partnership

- Agreement not honored, Partners cheat and go Scot free - Property rights are weak.

Business Premises

- Owned as well as rented. Traders fear eviction when business stands well established - again due to weak property rights.

Separate Chamber

- Industrialists do not work for the cause of the traders. There should be a separate chamber for traders.

Consolidation

Rare. Entrepreneurs do not want to delegate. One reason for this could be the lack of education.

One key policy change that would improve business

- End to load shedding
- Removal of professional tax
- Rule of Law

Branding

- No effort towards brand development: Reasons include lack of funds and entrepreneurs lack of inclination towards delegation.

Cost of doing Business

- Recently imposed professional tax on traders be withdrawn
- Parking space on G.T. road for customers
- Dilapidated state of roads and overflowing sewerage lines should be taken care off.

Business failure:

One trader, amongst those present, encountered failure due to competition from Chinese products.

List of Participants

PIDE

M. Idrees Khawaja Research Associate

Entrepreneurs:

- | | |
|----------------------------|-------------------------------------|
| 1. Dr. Mahmood Ahmad | Dentist (President Anjuman Tajaran) |
| 2. Nasrullah Butt | Crockery |
| 3. M. Ahmad Shahzad | Melting |
| 4. Chaudhry M. Hafeez | Washing Machine (Wholesaler) |
| 5. Chaudhry Safiullah | Book Seller |
| 6. M. Naeem Asif | Pump Dealer |
| 7. Khawaja Safi-ur-Rehman | Plastic (Wholesaler) |
| 8. Malik Imtiaz Ahmad | Crockery |
| 9. Chaudhry M. Anis | Iron Sheet |
| 10. Malik Abdul Khaliq | Dry Cleaning |
| 11. Haji Abdul Rauf Mughal | Furniture |
| 12. M. Naeem Butt | Books |
| 13. Talat Mughal | Motor Bearings |
| 14. Hafeez M. Akram | Jewelry |
| 15. Shaikh Pervaiz Ahmad | Shoes |
| 16. Mir Marghub | Electronics |
| 17. Naeem A. Shaikh | Hosiery |
| 18. Mubashir Rehan Bhatti | Sanitary (Wholesaler) |
| 19. Lala Liaqut Ali | Milk Trader |
| 20. Chaudhry Javaid | Garments (Wholesaler) |
| 21. Hafeez Inam ullah | General Store |
| 22. Yasir Mughal | Bricks |
| 23. Mirza M. Saleem | Printing Press |
| 24. Hakeem Aman ullah | Hikmat |

LEGAL IMPEDIMENTS

There is a need for lawful acquisition of land and protection of property rights for the entrepreneurs. "Asset security" needs to be backed by legal and social institutions. Land is one of the most important assets for people in rural and urban areas. Land record management system in Pakistan is outdated and allows for corruption and rent seeking through manipulations.

For example, the **Transfer of Property Act (1882)** does not envision that the state will guarantee title to property. As a result the documents exchanged between a vendor and a vendee do not certify title; even after the registrar enters the transaction in official records, it does not give any assurance of title to the transferor of property.

Similarly, according to **Rule 135 of the Registration Rules (1929)**, it is not the registrar's concern to establish any validity of the document. The **Registration Act (1908)** envisages the registration of documents and not the registration of titles itself. Thus, Land titling is not secure. Given this, the Mafias and Unions in the cities and the "potwaris" in the villages, possess a great threat for the urban and rural entrepreneurs; and this makes it extremely difficult for any type of activity including domestic commerce to find space for development.

Moreover, an Act widely being misused in Pakistan is the **Land Acquisition Act (1894)**. **Sub section (1) of Section 4** allows for occupation of private lands by the government in 'public interest'. Even though there are rules for land acquisition such as publication of a preliminary notification of the interest in an official gazette, giving the land/house owner a seven days notice before taking any legal action, 'adequate' compensatory is also envisaged. (details of which are contained in **sub section 1 of section 23**). In practice this act is used against the poor. Compensation is always inadequate especially when land is to be rezoned. The poor never get the benefit of the rezoning. Hence, 'public interest' is often interpreted by the governments in favor of the elite.

Furthermore, the **Cooperatives Society Act (1925)**, made for promoting the well-being of poor farmers, is now being used for the development of rich city housing projects for the influential groups. Cooperatives formed by powerful groupings then use the land acquisition act in their favor. Those who lose are the poor.

As noted in the paper the current zoning laws seek to "exclude the poor!" Any construction other than a single family house is regarded as commercial. The result is construction which is a labor intensive activity is a small infant industry. High rises, retail and commercial establishments are all extremely difficult to develop. Large commercialization fees are charged. There are also very harsh height and setback conditions. Neighbors also have the right to veto such projects.. The result is that a whole range of employment expanding options are closed. A whole range of entrepreneurship is discouraged as a result.

Dwellings for the poor and even the lower middle classes remain in short supply because of the commercialization policy that limits flat construction in high rises. In addition a rent control act that secures the tenant against the landlord and limits the rent increases serves to reduce the supply of rental property to the poor.

If the poor are to be helped a whole range of zoning laws and regulations need to be examined from the standpoint of including the poor. At the same time rent control has to be eliminated to allow the poor to be rent worthy.